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No. 99-

IN THE
Supreme Court of the United States

OCTOBER TERM, 1999

MCI COMMUNICATIONS CORPORATION AND SUBSIDIARIES AND TELECOM*USA, INC. AND SUBSIDIARIES,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a federal court should give deference to an Internal Revenue Service Revenue Ruling when interpreting the Internal Revenue Code.

2. Whether the court of appeals correctly interpreted former Section 49(d) of the Internal Revenue Code to deny the depreciation deductions claimed by petitioners.

PARTIES TO THE PROCEEDING

Petitioners are now owned by MCI WorldCom, Inc. There are no petitioners or respondents in addition to those named in the caption. On September 14, 1998, MCI Commu-nications Corporation merged with TC Investments, Inc., a wholly owned subsidiary of WorldCom, Inc. TC Investments, Inc. was renamed MCI Communications Corporation. The parent company, WorldCom, Inc., was renamed MCI WorldCom, Inc. MCI Communications Corporation owns 91.83 percent of MCI WorldCom Financial Management Corporation and has no other non-wholly-owned subsidiaries. MCI WorldCom, Inc. has no parent company and no subsidiaries other than wholly owned subsidiaries. Prior to December 30, 1998, Telecom*USA, Inc. was a subsidiary of MCI Financial Management Corporation. On December 30, 1998, MCI Financial Management Corporation was renamed MCI WorldCom Financial Management Corporation. MCI WorldCom Financial Management Corporation is 91.83 percent owned by MCI Communications Corporation and 8.17 percent owned by MCI International, Inc. Telecom*USA, Inc. has no subsidiaries other than wholly owned subsidiaries.

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PETITION FOR A WRIT OF CERTIORARI

MCI Communications Corporation and its subsidiaries ("MCI") and Telecom*USA, Inc. and its subsidiaries ("TUSA") (collectively "petitioners"); petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-25a) is reported at 192 F.3d 1068 (D.C. Cir. 1999). The opinion of the district court (Pet. App. 26a-39a) is reported at 26 F. Supp. 2d 6 (D.D.C. 1998).

JURISDICTION

The jurisdiction of the district court was invoked under 28 U.S.C. § 1346(a)(1). The judgment of the court of appeals was entered on October 15, 1999. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

The statutory provisions at issue, former sections 46, 48, and 49 of the Internal Revenue Code, are set forth in the appendix. Pet. App. 40a-44a.

STATEMENT

This case presents an important and unresolved question as to whether the federal courts, when interpreting the Internal Revenue Code, must defer to Revenue Rulings of the Internal Revenue Service. While it is established that *Chevron* deference is due to Treasury Regulations interpreting the Code (*see Atlantic Mut. Ins. Co. v. Commissioner*, 523 U.S. 382, 389 (1998)), the lower federal courts are divided as to whether Revenue Rulings are entitled to deference, and this Court has recently recognized that the question is an open one.

Petitioners and their affiliates together operate one of the world's largest and most technologically advanced communications networks. In the early and mid-1980s, petitioners were

laying the roadbed for what would later become a part of the information superhighway. As part of this effort, they purchased equipment for which a federal investment tax credit was provided. The purchase of this equipment was made in part in reliance on the investment tax credit.

In the Tax Reform Act of 1986, Congress repealed the investment tax credit for property purchased in or after 1986. Tax Reform Act of 1986, Pub. L. No. 99-514, § 211, 100 Stat. 2085, 2166-70 (codified as amended 26 U.S.C. § 49 (1988)). Recognizing that many taxpayers had already committed to invest in certain property in reliance on the credit, however, Congress phased out the credit for property purchased before 1986 but placed into service in 1986 or later. This was defined under the statute as "transition property." I.R.C. § 49(e) (26 U.S.C. § 49(e) (1988)).[1] Congress reduced the percentage of available tax credit for the transition property over time, depending on the year such property was placed into service and the year the credit was actually used by the taxpayer. Thus, for calendar year taxpayers, transition property placed in service in 1986 was entitled to the full 10 percent credit. The credit was reduced to 8.25 percent of cost for transition property placed in service in 1987 and reduced further to 6.5 percent of cost for property placed in service in 1988 or later. I.R.C. § 49(c).

This phased percentage reduction also applied to all credits that were carried forward from the year in which they were first available to the taxpayer. Thus, a 1986 credit amount carried forward for use by the taxpayer in 1987 was reduced from 10 percent to 8.25 percent of cost. Credit amounts carried forward to 1988 and beyond were reduced to 6.5 percent of cost. These phased percentage reductions were known as the "ITC haircut." (Pet. App. 4a).

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[1] All citations to sections 46, 48, 49 of the Internal Revenue Code contained in this petition are to the 1988 version.

Congress specifically designed these investment tax credit percentage reductions to coincide with phased-in decreases in the maximum corporate tax rate also implemented by the Tax Reform Act of 1986. (Pet. App. 29a). Under the Act, the maximum corporate tax rate declined from 46 percent to 40 percent in 1987, and from 40 percent to 34 percent in 1988 and thereafter. Tax Reform Act of 1986, Pub. L. No. 99-514, § 101, 100 Stat. 2096. By coordinating the investment tax credit percentages with the tax rates, Congress sought to ensure that taxpayers making the same investments in creditable property received the same after-tax results, regardless of when they placed their property in service or when they were able to use their credit. The increase to a taxpayer in after-tax funds resulting from the decreasing tax rates was directly proportionate to the percentage decrease in the investment tax credit each year. (Pet. App. 29a).

Beginning in 1962, when Congress provided for an investment tax credit, it reduced the basis by the amount of the credit. Revenue Act of 1962, Pub. L. No. 87-834, § 2, 76 Stat. 960, 962-73. Economically, this adjustment to basis ensured that a taxpayer could deduct only the full amount of its investment in the property after the credit. This prevented taxpayers from realizing a double benefit from the investment tax credit, once as a credit and once as a deduction.

At different times in the history of the investment tax credit, however, Congress provided that the basis should not be reduced by the full amount of the credit. In the Revenue Act of 1964, for example, Congress repealed the basis reduction provision, choosing to impose no basis reduction at all and actually permitting the double benefit of a credit and a deduction in an attempt to increase the incentive effect of the investment credit. Revenue Act of 1964, Pub. L. No. 88-272, § 203, 78 Stat. 19, 33; S. Rep. No. 88-830, Pt. 1 at 40-41 (1964). In the Tax Equity and Fiscal Responsibility Act of 1982, Congress required a reduction in basis of only 50 percent

of the investment tax credit amount. Pub. L. No. 97-248, § 205(a), 96 Stat. 324, 427 (adding I.R.C. § 48(q)). In the Tax Reform Act of 1986, Congress reinstated a full basis adjustment requirement for "transition property" qualifying for the investment tax credit. Pub. L. No. 99-514, § 211, 100 Stat. 2166.

As growing companies in an emerging industry, petitioners did not have sufficient income tax liability to take advantage of the investment tax credit in the years in which they placed their transition property in service. (Pet. App. 5a-6a). They also did not have sufficient income tax liability in prior years to carry back credits under Section 39 of the Internal Revenue Code. Accordingly, under Section 39, petitioners were required to carry forward their investment tax credits to tax years after 1988. (Pet. App. 6a). Under Section 49 of the Code, petitioners were required to reduce the amount of the credit they could take from the original credit amounts of 10 percent of cost for 1986 or 8.25 percent of cost for 1987 to a minimum credit of only 6.5 percent of cost on all of their transition property. As a result of the reduced investment tax credit percentage, MCI ultimately received $21,389,372 less of an investment tax credit than it would have received if it had not been required to carry its credits forward. TUSA ultimately received $1,004,799 less of an investment tax credit than it would have received if it had not been required to carry its credits forward. There is no issue concerning the appropriate amount of the credit reduction. Rather, the issue is the proper amount of the cost basis reduction.

In calculating depreciation deductions on tax returns originally filed for the 1986 through 1990 tax years, petitioners reduced the cost basis of their transition property by the amount of the investment tax credit to which they would have been entitled had they been able to use the credit in the years in which the property was placed in service. (Pet. App. 5a).

Petitioners filed claims for refund with the Internal Revenue Service ("IRS"), seeking to amend their original tax returns to calculate the basis of their transition property using the reduced amounts of credit they actually received rather than the original, theoretically-available credit amounts that had been used initially. The net effect was a dollar-for-dollar reduction in the basis for each dollar of available investment tax credit. The Internal Revenue Service, relying on Revenue Ruling 87-113, 1987-2 C.B. 33, determined that this was not sufficient and that the basis had to be reduced by the amount of the originally available unused investment credit. (Pet. App. 5a). This reduced the basis by an additional amount in excess of $20 million.

Revenue Ruling 87-113, issued on November 9, 1987, contained a hypothetical example addressing the issue of the adjustment to basis in the event of a carryforward of the credit. In the Ruling's example, a taxpayer purchased a $1,000,000 machine in 1985 and placed it in service in 1986, a year in which the tax credit was 10 percent of cost, or $100,000. The taxpayer was "unable to use the $100,000 credit until 1988, when it is used as a business credit carryforward from 1986." The IRS concluded that the taxpayer had to reduce the basis of the property by $100,000 even though the actual amount of the credit eventually taken was only $65,000. The Ruling provides that the taxpayer "is not allowed to increase its basis in the property to reflect the reduction in the investment credit carryforward." The Revenue Ruling offered no explanation or rationale for this conclusion.

In February 1996, petitioners filed suit in United States District Court for the District of Columbia, pursuant to 28 U.S.C. § 1346(a)(1) and Section 7422 of the Internal Revenue Code, seeking the additional depreciation deductions disallowed by the IRS. (Pet. App. 30a). There were no factual disputes between the parties.

Petitioners asserted, *inter alia*, that the statutory language and legislative history of former Sections 46, 48, and 49 of the Internal Revenue Code provided for the upward basis adjustments. Section 48(q)(1) of the Internal Revenue Code provides that "if a credit is determined under section 46(a) . . . the basis of such property shall be reduced by [100 percent] of the credit so determined." (as modified by I.R.C. § 49(d)(1)(A), changing 50 percent to 100 percent). Petitioners asserted that Section 49(c), the section imposing the haircut reduction for both current-year and carryforward credits, must be read with Section 46. When these sections are read together, "the amount of the credit so determined" under Section 46(a) is necessarily reduced by the amount of the haircut reduction of carryforward credits. Petitioners also relied on legislative history, which, they urged, plainly recognized their entitlement to the full depreciation deduction, *see, infra*, pp. 18-19, and on the traditional ability of taxpayers to recover at least their full cost for business property.

On cross motions for summary judgment the district court denied petitioners' refund claims. Relying on the Federal Circuit's opinion in *B.F. Goodrich Co. v. United States*, 94 F.3d 1545 (Fed. Cir. 1996), the district court rejected petitioners' argument that Sections 46, 48, and 49 of the Internal Revenue Code and the legislative history of the Tax Reform Act of 1986 provided for the increase in basis. While the district court cited Revenue Ruling 87-113, it did not even suggest that the ruling garnered deference under *Chevron v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), or otherwise.

On appeal, the United States, in addition to arguing that the language and legislative history of the statute supported its interpretation, urged deference to the Revenue Ruling, relying on the Fifth Circuit's decision in *Foil v. Commissioner*, 920 F.2d 1196, 1201 (5th Cir. 1990), which had afforded deference to such Revenue Rulings. (Appellee's Br. at 34). In response,

MCI argued that Revenue Rulings were not entitled to deference, relying on longstanding decisions of the Tax Court.[2]

At oral argument, the court called counsels' attention to language of this Court's decision in *Davis v. United States*, 495 U.S. 472 (1990), which suggested that Revenue Rulings were entitled to deference. As the Court of Appeals noted, at "oral argument, counsel . . . agreed that the *Davis* standard governs" court of appeals consideration of the issue and that, under *Davis*, "some deference would be due" the Revenue Ruling "if it were consistent with the language and legislative history." (Pet. App. 10a & n.11). Such deference was conceded to be appropriate because of the obligation of the courts of appeals to follow this Court's language as well as its specific holdings. *See, e.g., Rivers v. Roadway Express, Inc.*, 511 U.S. 298, 312 (1994) ("[O]nce the Court has spoken, it is the duty of other courts to respect that understanding of the governing rule of law.").[3]

The District of Columbia Circuit affirmed the district court, finding that petitioners had not met their burden of demonstrating a clear entitlement to the basis adjustments sought and deferring to Revenue Ruling 87-113. The court acknowledged that petitioners' interpretation of the relevant statutory provisions and legislative history was reasonable, but concluded that the government's position was "at least as reasonable as that of" petitioners. (Pet. App. 17a-18a). Thus, the court's decision turned in substantial part upon the question

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[2] "The government suggests that Rev. Rul. 87-113, which merely states its litigating position without rationale of any sort, supports its arguments. That ruling should be accorded no deference." (Appellant's Rep. Br. at 19).

[3] At the time, counsel apparently was not aware of this Court's subsequent decisions leaving open this precise question. *See infra* pp. 9-11.

of whether Revenue Rulings are entitled to deference. (Pet. App. 10a)

In deferring to the Revenue Ruling, the court recognized a dual conflict — first between the Tax Court and several courts of appeals as to whether Revenue Rulings are entitled to deference, and second, as to the level of deference to which they are entitled. (Pet. App. 7a-10a). The court avoided resolution of the second conflict.

This petition followed.

REASONS FOR GRANTING THE WRIT

This Court's decisions concerning whether Revenue Rulings are entitled to deference has supplied no clear guidance to litigants and lower courts. The issue has been frequently litigated in the lower courts, and that litigation has resulted in deep and long-standing conflict between the Tax Court and some courts of appeals and among the courts of appeals. The District of Columbia Circuit's decision below, affording deference, deepens the rift. Among those courts affording deference, a second widespread split exists as to the appropriate level of deference and the application of *Chevron*.

This Court should grant review to resolve these splits of authority. Indeed, only last Term, the Court granted certiorari to determine whether regulations issued by the United States Customs Service are entitled to judicial deference under *Chevron*. *United States v. Haggar Apparel Co.*, 526 U.S. 380 (1999). The issue in this case is even more important and far-reaching than that in *Haggar* because it involves Revenue Rulings issued by the Internal Revenue Service. The question whether such Rulings are entitled to deference is of tremendous practical importance both to every taxpayer in the Nation and to the Federal Government because it affects a large portion of the tax revenue raised each year.

I. THIS COURT'S PRECEDENT PROVIDES LITTLE GUIDANCE TO LOWER COURTS ON WHETHER DEFERENCE IS OWED TO REVENUE RULINGS

A Revenue Ruling is "an official interpretation by the Service which has been published in the Internal Revenue Bulletin." Treas. Reg. § 601.201(a)(6); Treas. Reg. § 601.601(d)(2)(i)(a); Rev. Proc. 99-1, 1999-1 I.R.B. 6; Rev. Proc. 89-14, 1989-1 C.B. 814. The vast majority of Revenue Rulings, including this one, are adopted without public comment. Comments "may be solicited," but only if "justified by special circumstances." Treas. Reg. § 601.601(d)(2)(v)(f). A Revenue Ruling is not a statement of general applicability, as is a formal regulation. *See* Treas. Reg. 601.601(d)(2)(v)(a); Rev. Proc. 89-14, 1989-1 C.B. 814. Rather, a Revenue Ruling is limited to the facts addressed therein, and is subject to change by subsequent legislation, regulations, court decisions, or even other Revenue Rulings. *See* Treas. Reg. §§ 601.601(d)(2) (v)(a), (e). Revenue Rulings are not published in the Federal Register or codified in the Code of Federal Regulations. *See* Treas. Reg. § 601.201(a)(6). They are instead published weekly in the Internal Revenue Bulletin. *See id.* According to the IRS, Revenue Rulings are intended to promote uniform application of the tax laws by IRS employees and to keep taxpayers and IRS employees informed of IRS National Office interpretations of the revenue laws. Rev. Proc. 89-14, 1989-1 C.B. 814.

Despite the language in *Davis v. United States*, 495 U.S. 472 (1990), relied on by the court below (Pet. App. 8a), this Court has never ruled conclusively whether Revenue Rulings should be afforded deference. For many years, the Court described Revenue Rulings as of "little aid in interpretating a tax statute." *Biddle v. Commissioner*, 302 U.S. 573, 582 (1938). And in *Dixon v. United States*, 381 U.S. 68 (1965), the Court reemphasized that "the Commissioner's rulings have only such force as Congress chooses to give them, and

Congress has not given them the force of law." *Id.* at 73. Yet, the *Davis* Court held (without citing *Chevron*) that a Revenue Ruling may be entitled to "considerable weight" if it "involve[s] the contemporaneous construction of a statute," has "been in long use," and Congress reenacts the relevant statute "using the same language, indicat[ing] its apparent satisfaction with the prevailing interpretation of the statute." 495 U.S. at 482, 484. The facts of *Davis* were unusual.[4]

More recently, this Court has expressed doubts as to the *Davis* approach. Only two years after *Davis*, the Court suggested in *dicta* that no deference might be due Revenue Rulings. In *United States v. Thompson Center Arms Co.*, 504 U.S. 505 (1992), the government asked the Court to defer to two Revenue Rulings in determining whether pistols with short-barrels and attachable shoulder stocks were "firearms" for purposes of a tax provision levying a $200 tax on anyone "making" a "firearm." *Id.* at 506-07, 518 n.9. The Court was skeptical of the appropriateness of this course, stating "*[e]ven if they were entitled to deference*, neither of the rulings . . .

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[4] Parents of Mormon missionaries sought charitable deductions for funds transferred to their children during their missionary service. *See Davis*, 495 U.S. at 473-74. The deduction was allowable only if the words "for the use of" in Section 170 of the Internal Revenue Code were interpreted broadly. *See id.* at 479. The Court engaged in an exhaustive analysis of the text, history, and structure of Section 170, ultimately concluding that Congress intended to allow deductions only when funds were given directly to a charity or to a trust (or similar entity) that held funds for the charity's benefit. *See id.* at 480-81. The IRS' Revenue Rulings consistently had interpreted Section 170 the same way. *See id.* at 481-82. Further, Congress had re-enacted section 170 "using the same language, [thereby] indicat[ing] its apparent satisfaction" with the IRS position. *Id.* at 482. Thus, even though Revenue Rulings "do not have the force and effect of regulations," (*id.* at 484), the rulings at issue were "*entirely faithful* to Congress' understanding." *Id.* at 482 (emphasis added). Accordingly, "[u]nder the circumstances presented," there was "good reason to accept the IRS' interpretation." *Id.* at 484.

goes to the narrow question presented here . . . ." *Id.* at 518 n 9 (emphasis added). The next Term, this Court likewise expressed serious doubt as to whether revenue rulings are due any sort of deference. "Because of the nature and limitations of [Revenue] [R]ulings, *we express no view* as to whether they are or are not entitled to deference. *The resolution of that issue is deferred to another day*." *Commissioner v. Keystone Consol. Indus., Inc.*, 508 U.S. 152, 162 n 3 (1993) (emphasis added). Finally, in *Commissioner v. Schleier*, 515 U.S. 323 (1995), the Court cited *Davis* for the proposition that Revenue Rulings "do not have the force and effect of regulations" and "may not be used to overturn the plain language of a statute." *Id.* at 336 n 8. Conspicuously absent, however, was any mention of a rule of deference. Indeed, Justice O'Connor, the author of *Davis*, dissented and specifically took issue with the majority's failure to invoke *Davis*' deference language. *See id.* at 345 (O'Connor, J., dissenting).

In summary, this Court's post-*Davis* precedent indicates that whether Revenue Rulings are entitled to deference is an open question. This uncertainty has been noted by a number of commentators: "The Supreme Court offers little clear guidance on how courts are to treat Revenue Rulings." J. Coverdale, *Court Review of Tax Regulations and Revenue Rulings in the* Chevron *Era*, 64 Geo. Wash. L. Rev. 35, 81 (1995); *see* L. Galler, *Judicial Deference to Revenue Rulings: Reconciling Divergent Standards*, 56 Ohio St. L.J. 1037, 1094 (1995) [hereinafter Galler, *Judicial Deference*] (Court should issue a "definitive ruling").

II. THE DECISION BELOW DEEPENS A SPLIT AMONG THE LOWER FEDERAL COURTS

The lack of clear guidance from this Court as to whether Revenue Rulings are entitled to deference is reflected in the deep splits of authority among the courts of appeals and the Tax Court on the issue, and among the courts of appeals themselves. In the light of this Court's decisions in

Thompson/Center Arms Co., *Keystone Consolidated Indus.*, and *Schleier* leaving this question open, this split is likely to broaden.

The Tax Court, which of course holds "special expertise in tax matters" (*United States v. Allen-Bradley Co.*, 352 U.S. 306, 311 (1957) (Harlan, J., concurring)), consistently has applied its "well-established principle" that "a revenue ruling merely represents the Commissioner's position with respect to a specific factual situation" and "do[es] not constitute substantive authority for a position." *Stark v. Commissioner*, 86 T.C. 243, 250-52 (1986) (internal quotation marks omitted); *accord, e.g.*, *Pasqualini v. Commissioner*, 103 T.C. 1, 8 & n.8 (1994); *Rath v. Commissioner*, 101 T.C. 196, 205 n.10 (1993). Accordingly, a Revenue Ruling is "only the contention of one of the parties to the litigation" and "not entitled to any special deference." *Crow v. Commissioner*, 85 T.C. 376, 389 (1985); *accord, e.g.*, *Northern Indiana Pub. Serv. Co. v. Commissioner*, 105 T.C. 341, 350 (1995), *aff'd*, 115 F.3d 506 (7th Cir. 1997) ("Revenue rulings represent 'merely the opinion of a lawyer in the agency and must be accepted as such,' and are not binding on the . . . courts.'" (quoting *Stubbs, Overbeck & Assocs., Inc. v. United States*, 445 F.2d 1142, 1146-47 (5th Cir. 1971)). Thus, the Tax Court's position is entirely consistent with this Court's holding in *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988), that deference to "an agency's convenient litigating position" is "entirely inappropriate." *Id.* at 213.

The court below specifically acknowledged the split in authority (Pet. App. 8a n.4), as has the Fifth Circuit. In *Estate of McLendon v. Commissioner*, 135 F.3d 1017, 1023 (5th Cir. 1998), the Fifth Circuit noted that even in the face of contrary court of appeals precedent, "the Tax Court stands firm in its own position that revenue rulings are nothing more than legal contentions of a frequent litigant, undeserving of any more or

less consideration than the conclusory statements in a party's brief."

While the court below suggested that "virtually all" circuits disagree with the Tax Court and afford some deference to Revenue Rulings, a number of courts of appeals in fact agree with the Tax Court's position. Thus, the Eleventh Circuit, in *Estate of Kostow v. Commissioner*, 45 F.3d 1524 (11th Cir. 1995), held that Revenue Rulings are "merely an opinion of an IRS attorney" and "are not binding on the courts." *Id.* at 1528 n.4. The Eighth Circuit has held fast to its holding in *Mercantile Bank & Trust Co. v. United States*, 441 F.2d 364 (8th Cir. 1971), that Revenue Rulings "are of little aid in interpreting statutes." *Id.* at 368 (citing *Biddle*, 302 U.S. at 582).[5] The Federal Circuit recently reaffirmed that Customs Rulings, as well as Revenue Rulings, deserve no deference because they "do not carry the force of law" and are not accompanied by the "procedural safeguards" of notice-and-comment rulemaking. *Mead Corp. v. United States*, 185 F.3d 1304, 1307 (Fed. Cir. 1999). The Tenth Circuit continues to caution that Revenue Rulings "do not have the force and effect of law" and gives them only "some consideration" (but apparently not deference) so long as they are not "contrary to statute or the expressed intention of Congress." *American Stores Co. v. Commissioner*, 170 F.3d 1267, 1278 (10th Cir.), *cert. denied*, 120 S. Ct. 182 (1999); *but cf. ABC Rentals of San Antonio, Inc. v. Commissioner*, 142 F.3d 1200, 1205 (10th Cir. 1998) (some deference appropriate if facts of the case match those of *Davis v. United States*, 495 U.S. 472).

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[5] The court below erroneously suggested that the Eighth Circuit affords deference by citing *United States v. Howard*, 855 F.2d 832 (11th Cir. 1988). (Pet. App. 9a n.10). In fact, *Howard* is an Eleventh Circuit decision, and the Eleventh Circuit has made clear that it affords no deference.

Other courts of appeals have directly disagreed with the Tax Court, including the Second, Third, Fourth, Fifth, Sixth, Seventh, and Ninth Circuits. *See Estate of McLendon*, 135 F.3d at 1024; *First Chicago NBD Corp. v. Commissioner*, 135 F.3d 457, 459 (7th Cir. 1998); *In re Kaplan*, 104 F.3d 589, 599 (3d Cir. 1997); *Walt Disney Inc. v. Commissioner*, 4 F.3d 735, 740 (9th Cir. 1993); *Johnson City Med. Ctr. v. United States*, 999 F.2d 973, 975 (6th Cir. 1993); *Wood v. Commissioner*, 955 F.2d 908, 913 (4th Cir. 1992). *See* L. Galler, *Emerging Standards for Judicial Review of IRS Revenue Rulings*, 72 B.U. L. Rev. 841, 857 (1992); *see also* Coverdale, 64 Geo. Wash. L. Rev. at 82-83.

There is a second conflict as well. The various courts of appeals affording deference to Revenue Rulings have adopted widely divergent standards of "deference."

In *Johnson City Medical Center*, the Sixth Circuit appeared to invoke *Chevron* deference in construing the effect of a Revenue Ruling. 999 F.2d at 975. Under its conception of *Chevron*, the Sixth Circuit ruled that "a Revenue Ruling is entitled to some deference unless 'it conflicts with the statute it supposedly interprets or with that statute's legislative history or if it is otherwise unreasonable.'" *Id.* (quoting *CenTra, Inc. v. United States*, 953 F.2d 1051, 1056 (6th Cir. 1992)). In dissent, Judge Batchelder rejected the suggestion that *Chevron* applied. *See id.* at 979 (Batchelder, J., dissenting).

Other courts of appeals have afforded lesser deference without explaining why. What has emerged is a morass of nebulously worded standards that purport to be something less than *Chevron* deference, but something more than *de novo* review. The Seventh Circuit has eschewed *Chevron* deference to Revenue Rulings, but affords them "respectful consideration." *First Chicago NBD Corp.*, 135 F.3d at 459. The Fifth Circuit likewise employs a "respectful consideration standard." *Foil v. Commissioner*, 920 F.2d 1196, 1201 (5th

Cir. 1990).[6] The Second Circuit has held that Revenue Rulings "'are entitled to great deference, and have . . . the force of legal precedent unless unreasonable or inconsistent with the provisions of the Internal Revenue Code.'" *Gillespie v. United States*, 23 F.3d 36, 39 (2d Cir. 1994) (quoting *Salomon, Inc. v. United States*, 976 F.2d 837, 841 (2d Cir. 1992)). The Fourth and Ninth Circuits appear to have adopted similar rules. *See Walt Disney Inc.*, 4 F.3d at 740 (citing *Salomon* favorably); *Wood*, 955 F.2d at 913 (Revenue Ruling may be given "considerable weight"). The Third Circuit's standard is particularly unclear. On the one hand, it has held that it merely "give[s] weight to IRS revenue rulings and do[es] not disregard them unless they 'conflict with the statute they purport to interpret or its legislative history, or if they are otherwise unreasonable.'" *Gillis v. Hoechst Celanese Corp.*, 4 F.3d 1137, 1145 (3d Cir. 1993). On the other hand, it has professed to afford Revenue Rulings "great deference." *In re Kaplan*, 104 F.3d at 599.

The District of Columbia Circuit's decision to "accord at least some deference" (Pet. App. 7a) to Revenue Ruling 87-113 flatly conflicts with numerous holdings of the Tax Court and decisions of the Eighth, Eleventh, and Federal Circuits. Further, the decision is at least in marked tension with decisions of the Tenth Circuit. Because the District of Columbia Circuit did not delineate the precise level of deference that it purported to accord, it is impossible to say with any certainty whether its approach conflicts with that of other circuits on the degree of deference.

The decisions of the courts of appeals that afford deference are highly questionable. Four primary factors counsel against deference:

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[6] The Fifth Circuit's present attitude toward Revenue Rulings is a dramatic shift from its earlier 1971 *Stubbs* holding.

First, the IRS is an enforcement entity charged with "general superintendence of the *assessment and collection* of all taxes imposed by any law providing internal revenue." Treas. Reg. § 601.101 (emphasis added). Accordingly, "the major responsibility of the . . . Service is to protect the public fisc." *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 542 (1979). On occasion, the IRS has been criticized for "overzealous . . . revenue collection" and "deliberate disregard for the clear purpose, intent and policy behind the [Internal Revenue Code]." *See Estate of Clayton v. Commissioner*, 976 F.2d 1486, 1499 (5th Cir. 1992). This enforcement zeal combined with the "availability of deference . . . encourages the IRS to issue rulings because the mere existence of a relevant revenue ruling improves the likelihood of the agency prevailing in cases that present the issue and may even assure a victory." Galler, *Judicial Deference*, *supra*, at 1086. Thus, as the Tax Court properly recognizes, Revenue Rulings essentially operate as "the contention of one of the parties to the litigation" and must not garner any deference. *Crow*, 85 T.C. at 389.

Second, as this Court recognized in *Haggar*, the fact that an agency position has been subjected to notice-and-comment rulemaking strongly impacts the decision to apply *Chevron* deference. *See* 526 U.S. at 491 ("Particularly in light of the fact that the agency utilized the notice-and-comment rulemaking process before issuing the regulations, the argument that they were not intended to be entitled judicial deference implies a sufficient departure from conventional administrative practice that we ought not to adopt . . . ."). Unlike Treasury Regulations, which are afforded *Chevron* deference (*see Atlantic Mut. Ins. Co. v. Commissioner*, 523 U.S. 382, 389 (1998)), Revenue Rulings are not subjected to the notice-and-comment process of the Administrative Procedures Act. *See* Treas. Reg. § 601.601(d)(2)(v)(d). These procedural protections "offset[] [the] institutional biases" that the IRS exhibits (Galler, *Judicial Deference*, *supra*, at 1086), and their absence precludes deference to Revenue Rulings. *See ABC*

Rentals, 142 F.3d at 1205 (Treasury Regulations, which are issued through notice-and-comment rulemaking, entitled to *Chevron* deference; Revenue Rulings, which are not similarly vetted, not entitled to deference); *accord Mead Corp.*, 185 F.3d at 1307 (Customs Rulings, like Revenue Rulings, do not fall within *Haggar*'s deference rule because they "do not carry the force of law" and are not accompanied by the "procedural safeguards" of notice-and-comment rulemaking); Coverdale, 64 Geo. Wash. L. Rev. at 87 ("Close judicial scrutiny of Revenue Rulings serves as an offset to the absence of notice-and-comment rulemaking in the promulgation of Revenue Rulings.").

Third, while deference may sometimes be due to agencies of the Treasury charged with revenue collection (*see, e.g.*, *Haggar*, 526 U.S. 380), where public notice and comment is not provided the IRS' pecuniary-type interest in the outcome of tax litigation also counsels against deference to the IRS' Revenue Rulings. *See TransOhio Sav. Bank v. OTS*, 967 F.2d 598, 614 (D.C. Cir. 1992) (refusing to defer "to an agency interpretation of a statute that w[ould] affect agreements to which the agency [was] party"); C. Sunstein, *Law and Administration After* Chevron, 90 Colum. L. Rev. 2071, 2076 (1990) (deference is inappropriate when "agency's self-interest is conspicuously at stake").

Finally, this Court has held that deference is owed only to an agency charged with administering a statute. *See Adams Fruit Co. v. Barrett*, 494 U.S. 638, 649 (1990) ("A precondition to deference under *Chevron* is a congressional delegation of administrative authority."). Without question, Congress had delegated to the Treasury Department the power to administer the Internal Revenue Code by, among other things, "prescrib[ing] all needful rules and regulations." I.R.C. § 7805(a). But Treasury Regulation § 601.601(d)(2)(i)(a) defines a Revenue Ruling as "an official interpretation *by the Service*." (emphasis added). Thus, in issuing Revenue Rulings,

the IRS speaks only on its own behalf, and not on behalf of the entire Treasury Department, which is statutorily charged with administering the Internal Revenue Code.

If deference were not afforded to Revenue Ruling 83-117, the court below would have had to make a *de novo* determination of the issue of statutory construction. Such *de novo* consideration should lead to allowance of the deduction. The language of the Tax Reform Act of 1986 provides for adjustment to the basis of depreciable assets only by the actual amount of the investment tax credit.

Section 48(q)(1) of the Internal Revenue Code, provides that "if a credit is determined under Section 46(a) . . . the basis of such property shall be reduced by [100 percent] of the credit so determined." 26 U.S.C. § 48(q)(1) (1988) (as modified by I.R.C. § 49(d)(1)(A), changing 50 percent to 100 percent). The government argued below that the amount of the credit is "determined" when the property is placed in service and the basis reduction required is only the amount determined at that time. However, Section 49(c), the section imposing the haircut reduction for both current-year and carryforward credits, reduces the amount of the credit "determined" for purposes of both the credit and the basis reduction. Accordingly, the amount of "the credit so determined" under Section 46(a) reduces the amount of the cost basis just as it reduces the amount of the credit.

The legislative history supports this result. The Conference Report stated:

> *Full basis adjustment*
>
> A taxpayer is required to reduce the basis of property that qualifies for transition relief ("transition property") by the full amount of investment credits earned with respect to the transition property (after application of the phased-in 35-percent reduction, described below) . . . .

Reduction of ITC carryforward and credits claimed under transitional rules

. . . .

Under the conference agreement, the investment tax credit allowable for carryovers is reduced by 35 percent. The reduction in investment tax credit carryovers is phased in with the corporate rate reduction. The 35-percent reduction is fully effective for taxable years beginning on or after July 1, 1987 . . . . The investment tax credit earned on transition property is reduced in the same manner as carryovers.

. . . .

As described above, a full basis adjustment is required with respect to the reduced amount of the investment tax credit. Thus, for transition property that is eligible for a 6.5 percent investment tax credit, the basis reduction would be with respect to the 6.5 percent credit, not the unreduced 10 percent credit.

H.R. Conf. Rep. No. 99-841, at II-63 to -64 (1986), *reprinted in* 1986 U.S.C.C.A.N. 4075, 4151-52 (underlining added).

Moreover, a contrary decision would constitute a clear departure from traditional principles of full cost recovery that underlie the concept of depreciation in the Internal Revenue Code. Under the IRS approach, the basis is reduced by the amount of the usual credit petitioners theoretically could have taken in an earlier tax year if they had not carried forward the credit. Petitioners are aware of *no* other instance where the Internal Revenue Code has denied taxpayers the opportunity to recover fully the cost of business assets through depreciation. Congress did not intend this unprecedented result here; it merely sought to ensure that a taxpayer unable to use the

credits immediately would not receive a greater benefit when coupled with an income tax rate reduction.[7]

III. RESOLUTION OF THIS ISSUE IS OF CRITICAL IMPORTANCE TO EVERY TAXPAYER AND TO THE FEDERAL GOVERNMENT

In fiscal year 1998, the IRS collected more than $1.7 trillion in tax revenue. *Treasury Department Gross Tax Collections: Amount Collected by Quarter and Fiscal Year 1987-1999* (visited Jan. 12, 2000) <http://www.irs.gov/tax_stats/soi/other_tc.html>. The deep and persistent split of authority on whether deference is owed Revenue Rulings strongly impacts every taxpayer as well as the government. Over the past five years, the IRS has, on average, issued more than one Revenue Ruling per week. Thousands of Revenue Rulings have been issued since 1953, the year that the IRS announced its present policy for promulgating Revenue Rulings. *See* M. Saltzman, *IRS Practice and Procedure* ¶ 3.03[2] n.12 (2d ed. 1991). And confusion over whether these Rulings rate deference continues to reign, with more than twenty reported decisions of the courts of appeals devoted to the issue in just the last ten years. "Th[is] lack of consistency among the circuits [has] result[ed] in inconsistent treatment of similarly situated taxpayers, who are confronted by a different rule depending upon the circuits in which they reside and the courts in which their disputes are heard." Galler, *Judicial Deference*, *supra*, at 1039-40.

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[7] While the court below suggested (Pet. App. 12a-13a) that the Federal Circuit had reached the same result without deference to the Revenue Ruling, in fact *B.F. Goodrich* involved a quite different issue. In *B.F. Goodrich*, the taxpayer urged that cost basis has to be determined when the property was put in service based on the taxpayer's "reasonable expectations" of the availability of credits in the near future. 94 F.3d at 1548. The Federal Circuit correctly held that the Code did not provide for basis adjustments based on "reasonable expectations." *Id.* at 1549. Here, the adjustments were made in a later year based on the actual facts as to the amount of the credit.

This is an unacceptable state of affairs. As the Ninth Circuit stated in *First Charter Finance Corp. v. United States*, 669 F.2d 1342, 1345 (9th Cir. 1982), "[u]niformity among the circuits is especially important in tax cases to ensure equal and certain administration of the tax system." This "issue has percolated long enough to show that the question is ripe for review" by this Court. Galler, *Judicial Deference*, *supra*, at 1094.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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January 13, 2000

APPENDIX

UNITED STATES COURT OF APPEALS,
DISTRICT OF COLUMBIA CIRCUIT

TELECOM*USA, INC., and subsidiaries, Appellants,

v.

UNITED STATES of America, Appellee.

Nos. 98-5361, 98-5362.

Decided Oct. 15, 1999

Before: WALD, RANDOLPH, and GARLAND, Circuit Judges.

Opinion for the Court filed by Circuit Judge GARLAND.

GARLAND, Circuit Judge:

Telecom*USA, Inc. and its subsidiaries, and MCI Communications Corporation and its subsidiaries, (collectively, "Telecom"), appeal the district court's ruling that Telecom is not entitled to the income tax refund it seeks. The case concerns transition rules enacted by Congress in 1986 to cushion the impact of the repeal of the investment tax credit (ITC). Telecom's principal contention is that its basis in depreciable property should be reduced by the amount of ITC it received in the year to which it carried its ITC forward. Following the lead of the Federal Circuit and the Court of Federal Claims, the district court rejected this argument and held that Telecom must instead reduce its basis by the larger amount of ITC first available to it in the year in which it placed the property in service. We agree with the district court and the other courts that have considered this issue, and affirm.

I

To put Telecom's claims in context, we begin with a brief history of the depreciation deduction and the ITC. The Internal Revenue Code has long provided for depreciation deductions through which a property owner can deduct the cost of its property over the property's useful life. *See* 26 U.S.C. § 167(a); 26 U.S.C. § 23(*l*) (1934); *United States v. Ludey*, 274 U.S. 295, 297-300, 47 S. Ct. 608, 71 L. Ed. 1054 (1927). Under the straight line method of depreciation, for example, an asset with an initial cost of $1,000,000, a salvage value of $50,000, and a useful life of 10 years would generate annual deductions of $95,000. *See* 26 U.S.C. § 167(b)(1) (1988); 26 C.F.R. § 1.167(b)-1. Various other methods of depreciation also have been permitted. *See, e.g.*, 26 U.S.C. § 167(b)(2) (1988) (double declining balance method), *id.* § 167(b)(3) (sum of the years-digits method); *see* 26 C.F.R. §§ 1.167(b)-2, 1.167(b)-3.

In the Economic Recovery Tax Act of 1981 (ERTA), Congress adopted a new set of depreciation rules called the Accelerated Cost Recovery System (ACRS). *See* Pub.L. No. 97-34, sec. 201(a), § 168, 95 Stat. 172, 203 (codified as amended at 26 U.S.C. § 168). Intended to stimulate economic expansion, ACRS permits recovery of capital costs for most tangible depreciable property by using accelerated methods over predetermined periods that are generally shorter than the useful life of the asset. *See* 26 U.S.C. § 168(e)(1); S. Rep. No. 97-144, at 48 (1981), U.S. Code Cong. & Admin. News at 105, 153. ACRS also eliminates the salvage value limitation, hence allowing the entire cost of the property to be depreciated. *See* ERTA, sec. 201, § 168(f)(9), 95 Stat. at 216.

Although not as old as the depreciation deduction, the investment tax credit dates back to the Kennedy Administration and was also designed to stimulate the economy by encouraging investment. *See* Revenue Act of 1962, Pub.L. No. 87-834, § 2, 76 Stat. 960, 962-73; H.R. Conf. Rep. No.

87-2508, at 14 (1962), U.S. Code Cong. & Admin. News at 3732, 3745. The most recent incarnation of the ITC, prior to amendment and repeal in 1986, gave taxpayers a one-time credit of 10% of the cost of the property. *See* 26 U.S.C. § 46 (1982). The credit was a dollar-for-dollar offset against a taxpayer's tax liability, *see id.* § 39(a), but could not be used if the taxpayer had insufficient tax liability for the year, *see id.* § 46(a)(3). The unused credits could, however, be carried back and carried forward a specified number of years to reduce the taxpayer's liabilities in those years. *See id.* § 46(b).

The combined use of ITCs and depreciation deductions gave taxpayers generous benefits. For an asset costing $1,000,000, the taxpayer could both claim an ITC of $100,000 (10% of the cost) and deduct $1,000,000 worth of depreciation (the full cost of the asset). In 1982, Congress concluded that this combination was distorting the allocation of capital resources and determined to reduce the level of benefits. *See* S. Rep. No. 97-494, at 122 (1982), U.S. Code Cong. & Admin. News at 781, 887-88. A new provision, enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), provided that an asset's "basis"—the value of the property used to determine the total available depreciation deductions—would be reduced by 50% of the amount of the ITC. *See* Pub. L. No. 97-248, § 205(a), 96 Stat. 324, 427 (codified at 26 U.S.C. § 48(q)(1) (1982)). Hence, although an asset originally costing $1,000,000 would continue to yield an ITC of $100,000, it would generate a total of only $950,000 worth of depreciation ($1,000,000 minus 50% of the $100,000 credit).

In 1986, Congress concluded that the ITC was still distorting investment activity by channeling too much investment into tax-favored sectors. *See* S. Rep. No. 99-313, at 96 (1986). Thus, in the Tax Reform Act of 1986, Congress repealed the ITC for property purchased in 1986 and thereafter. *See* Pub. L. No. 99-514, § 211, 100 Stat. 2085,

2166-70 (codified as amended at 26 U.S.C. § 49(a) (1988)).[1] It made an exception, however, for "transition property"—property purchased prior to 1986 but placed in service in 1986 or later. For such property, the ITC was phased out over a number of years. For calendar year taxpayers, transition property placed in service in 1986 received the full 10% credit; property placed in service in 1987 received a reduced credit of 8.25% of cost; and property placed in service in 1988 or later received a credit of only 6.5%. *See* 26 U.S.C. § 46; *id.* § 49(b), (c)(1), (c)(3)(A), (c)(5)(A) (1988).[2] The phased reduction is known colloquially as the ITC "haircut."

The 1986 amendments included two other changes of significance for this case. First, the haircut was also applied to credits carried forward from the year in which they were first available to the taxpayer. Credits carried forward for use in 1987 were reduced to 8.25%; those carried forward to 1988 and subsequent years were reduced to 6.5%. *See id.* § 49(c)(2), (c)(3)(B), (c)(5)(A). Second, the amount of the basis adjustment for purposes of determining depreciation was changed from 50% to 100% of the amount of the ITC. *See id.* § 49(d)(1).

The following year, the Internal Revenue Service (IRS, or "the Service") issued a revenue ruling to guide taxpayers with respect to the operation of the 1986 amendments. *See* Rev. Rul. 87-113, 1987-2 C.B. 33. Example 1 of that ruling considered the case of a $1,000,000 machine purchased in

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[1] The Tax Reform Act repealed the "regular" investment tax credit at issue here. *See id.* § 211, 100 Stat. at 2166; 26 U.S.C. § 49(a) (1988). Other investment credits survive. *See* 26 U.S.C. § 46.

[2] Telecom is a calendar year taxpayer. MCI Communications Corp. is a fiscal year taxpayer as to which slightly different percentages apply. *See id.* § 49(c)(3).

1985 and placed in service in 1986, the final 10% year. The ruling stated that under those circumstances, the taxpayer was entitled to an ITC of $100,000 (10% of the $1,000,000 cost) and had to reduce the machine's depreciable basis by 100% of that amount, (i.e., to $900,000).

But what if the taxpayer were unable to use the credit in 1986, and could not use it until 1988? Did the basis for depreciation deductions have to be reduced by the 10% credit available in 1986, the year the property was placed in service, or by the 6.5% credit available in 1988, the year to which the taxpayer carried the credit forward? Example 3 of Revenue Ruling 87-113 addressed that issue, and concluded that the basis had to be reduced by the amount of the credit available in the year the property was placed in service. In the example, the credit available to the company when the property was placed in service in 1986 was $100,000. Accordingly, following the 100% basis reduction rule, the basis had to be reduced to $900,000. This, the IRS concluded, was the case even though the amount of the credit the company received was only $65,000 when it was eventually used in 1988. The company, the IRS said, was "not allowed to increase its basis in the property to reflect the reduction in the investment credit carryforward." *Id.* at 35.

II

As Telecom acknowledges, its case presents the same situation as that addressed in Example 3 of Revenue Ruling 87-113, and the IRS has treated it in precisely the same way. *See* Telecom Br. at 18 n.12. Telecom owned transition properties placed in service in calendar years 1986 and 1987. The ITC percentages available for those properties in those years were 10% and 8.25%, respectively. When calculating its depreciation deductions in the years the properties were placed in service, Telecom reduced its bases by amounts that reflected those percentages. Telecom was unable to use its ITCs immediately, however, because it had insufficient tax liabilities

in those years; it therefore carried the credits forward to 1989 and thereafter. Under the ITC haircut, the percentage received by Telecom in those years was only 6.5%.[3]

Telecom filed claims for refunds with the IRS, seeking the additional depreciation deductions it could have taken had it calculated its properties' bases using the ITCs it actually received. The IRS denied the claims, and Telecom filed refund actions in the district court. Telecom advanced one principal theory and two alternatives in support of its position. Its principal contention was that several interconnected provisions of the Internal Revenue Code permitted it to amend its earlier returns by adjusting its properties' bases upward to reflect the amounts of ITC it actually used. Alternatively, Telecom argued that 26 U.S.C. § 168, as construed in a proposed treasury regulation, entitled it to adjust its bases in the carryforward years to reflect the effective change in the cost of its properties brought about by the haircut applied when its ITCs were carried forward. As a second alternative, Telecom contended that 26 U.S.C. § 196, which provides deductions for portions of tax credits that a taxpayer has not been allowed to use, entitled it to deductions for the difference between the amounts of ITC allowable in the initial and carryforward years.

The district court rejected Telecom's arguments on cross-motions for summary judgment. *See MCI Communications Corp. v. United States*, 26 F. Supp. 2d 6 (D.D.C. 1998). Relying both on Revenue Ruling 87-113 and on the opinion of the U.S. Court of Appeals for the Federal Circuit in *B.F.*

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[3] The "Telecom" reference in this paragraph is only to Telecom*USA, Inc. and its subsidiaries. As noted *supra* note 2, MCI Communications Corporation is a fiscal year taxpayer. It owns transition properties placed in service in fiscal years 1986, 1987, and 1988. The ITC percentages available for those properties were 10%, 10%, and 7.375%, respectively. Like Telecom, MCI carried its ITCs forward to 1989 and subsequent years. As the principles involved are the same, we confine our textual discussion to the calendar year situation faced by Telecom.

Goodrich Co. v. United States, 94 F.3d 1545 (Fed.Cir. 1996), which denied a taxpayer's virtually identical claim, the court rejected Telecom's argument that it should be permitted to adjust its original basis. The court also rebuffed Telecom's alternative efforts to utilize sections 168 and 196, holding those sections inapplicable to the circumstances at issue here.

III

On appeal, Telecom presses all of the arguments it raised below. There are no factual disputes, and we review the district court's grant of summary judgment de novo. *See Tao v. Freeh*, 27 F.3d 635, 638 (D.C.Cir. 1994). To decide this case, we must analyze the interplay of three quite technical statutory provisions. Fortunately, we are not left wholly to our own devices, but rather are assisted by two important interpretive guides. Equally fortunate, the two point in the same direction.

The first guide instructs that a taxpayer who seeks a deduction bears the burden of demonstrating a clear entitlement. *See New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440, 54 S. Ct. 788, 78 L. Ed. 1348 (1934) ("[O]nly as there is clear provision therefor can any particular deduction be allowed."); *Lenkin v. District of Columbia*, 461 F.2d 1215, 1225 (D.C.Cir. 1972) (applying *New Colonial Ice* rule to depreciation deductions); *cf. United States v. Centennial Sav. Bank FSB*, 499 U.S. 573, 583-84, 111 S. Ct. 1512, 113 L. Ed.2d 608 (1991) (citing "rule that tax-exemption and -deferral provisions are to be construed narrowly"); *United States v. Wells Fargo Bank*, 485 U.S. 351, 354-55, 108 S. Ct. 1179, 99 L. Ed.2d 368 (1988) ("[E]xemptions from taxation are not to be implied; they must be unambiguously proved."). At oral argument, Telecom agreed that it bears this burden, but insisted that its entitlement to deductions is clear.

The second interpretive guide requires us to accord at least some deference to the IRS' revenue ruling. Although a

revenue ruling does not have the force and effect of Treasury Department Regulations, *see* 26 C.F.R. § 601.601(d)(2)(v)(d), it does constitute "an official interpretation by the Service," *id.* § 601.601(d)(2)(i)(a). Accordingly, the Supreme Court and virtually all of the Circuits have indicated that revenue rulings are entitled to some degree of deference.[4]

In *Davis v. United States*, 495 U.S. 472, 484, 110 S. Ct. 2014, 109 L. Ed.2d 457 (1990), the Court indicated that revenue rulings are entitled to "considerable weight where they involve the contemporaneous construction of a statute and where they have been in long use"[5]—two conditions that are roughly satisfied here.[6] Davis did not, however, address how this standard compared to the relatively high level of deference applicable to agency interpretations of ambiguous statutes under *Chevron U.S.A. Inc. v. Natural Resources Defense*

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[4] *See generally Estate of McLendon v. Commissioner*, 135 F.3d 1017, 1023 (5th Cir. 1998) (noting that "virtually every circuit recognizes some form of deference," and that only the Tax Court takes the "position that revenue rulings are nothing more than the legal contentions of a frequent litigant") (citing *Pasqualini v. Commissioner*, 103 T.C. 1, 8, 1994 WL 371893 (1994)); John F. Coverdale, *Court Review of Tax Regulations and Revenue Rulings in the Chevron Era*, 64 Geo. Wash. L. Rev. 35, 81-84 (1995).

[5] Subsequently, in *United States v. Thompson/Center Arms Co.*, the Court spoke neutrally to the question of whether deference was due, stating that "even if they were entitled to deference," the revenue rulings proffered in that case did not apply to the questions there at issue. 504 U.S. 505, 518 n. 9, 112 S. Ct. 2102, 119 L. Ed.2d 308 (1992). In *Commissioner v. Schleier*, the Court noted that revenue rulings "may not be used to overturn the plain language of a statute," 515 U.S. 323, 336 n. 8, 115 S. Ct. 2159, 132 L. Ed.2d 294 (1995), a point consistent with all of the varieties of deference cited *infra* notes 8, 9, & 10.

[6] Revenue Ruling 87-113 was issued the year following the 1986 amendments, and has constituted the Service's consistent position for the 12 years since it was issued.

Council, Inc., 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed.2d 694 (1984).[7] The Courts of Appeals have accorded revenue rulings varying degrees of deference, ranging from the level utilized in *Chevron*,[8] to "some weight,"[9] to variations in between.[10]

This court has not had the occasion to decide the precise degree of deference due to revenue rulings, although we have referred to such rulings as "the second most important agency pronouncements that interpret the Code" and have looked to

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[7] *Chevron* held that if a "statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843, 104 S. Ct. 2778.

[8] *See Johnson City Med. Ctr. v. United States*, 999 F.2d 973, 975-76 (6th Cir. 1993) (adopting *Chevron*-like deference).

[9] *See, e.g., First Chicago NBD Corp. v. Commissioner*, 135 F.3d 457, 458-59 (7th Cir. 1998) (holding that revenue rulings deserve "some weight" and are "entitled to respectful consideration," but "not to the deference that the Chevron doctrine requires in its domain") (citations omitted); *Farmar v. United States*, 231 Ct. Cl. 642, 689 F.2d 1017, 1024 n. 12 (Ct. Cl. 1982) (stating that revenue rulings "are entitled to some consideration and carry some weight," and noting "Commissioner's authority to choose between reasonable interpretations").

[10] *See, e.g., Gillespie v. United States*, 23 F.3d 36, 39 (2d Cir. 1994) ("Revenue rulings issued by the IRS are entitled to great deference, and have been said to have the force of legal precedent unless unreasonable or inconsistent with the provisions of the Internal Revenue Code.") (internal quotation marks and citations omitted); *Gillis v. Hoechst Celanese Corp.*, 4 F.3d 1137, 1145 (3d Cir. 1993) ("We give weight to IRS revenue rulings and do not disregard them unless they conflict with the statute they purport to interpret or its legislative history, or if they are otherwise unreasonable.") (internal quotation marks and citations omitted); *Foil v. Commissioner*, 920 F.2d 1196, 1201 (5th Cir. 1990) (noting that revenue rulings are entitled to "respectful consideration," but will be disregarded if in conflict with the statute or its legislative history, or if otherwise unreasonable); *United States v. Howard*, 855 F.2d 832, 836 (8th Cir. 1988) (giving "weight" and according "respectful consideration").

them when neither the statute nor Treasury regulations provided clear guidance. *Stichting Pensioenfonds Voor de Gezondheid v. United States*, 129 F.3d 195, 198 (D.C.Cir. 1997). We need not announce a precise calibration here, either. Telecom does not dispute that some deference would be due Revenue Ruling 87-113 if it were consistent with the statute's language and legislative history, although it argues that even then the degree of deference should be minimal.[11] But utilizing even a minimal level of deference—or imposing only a minimal burden of clarity under the first interpretive guide discussed above—is sufficient to decide this case. As we discuss below, the IRS' construction of the statute is more than consistent with the statutory language and legislative history, and Telecom has been unable to point to anything that, with any measure of clarity, entitles it to the deductions it seeks.

IV

In this Part, we consider Telecom's first claim: that under the 1986 amendments, the basis of transition property should be reduced by the actual amount of ITC ultimately used by the taxpayer, rather than by the amount available in the year in which the asset is placed in service.

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[11] At oral argument, counsel for Telecom agreed that the *Davis* standard governs, but argued for a minimal level of deference because Revenue Ruling 87-113 does not contain an express explanation for its construction of the relevant statutory sections. The ruling does, however, discuss the same statutory language upon which the IRS relies in this case, and sets forth the Service's interpretation of that language. It notes that "section 48(q)(1) requires the taxpayer to reduce the basis" by the "credit determined," and subsequently states that the "basis must be reduced in the year the property is placed in service." Rev. Rul. 87-113, 1987-2 C.B. 33, 34-35. *Compare* discussion *infra* Part IV.A. Counsel conceded that this degree of explanation would ordinarily be entitled to some weight, were it not for the assertedly contrary legislative history discussed *infra* Part IV.B.

A

The government's contrary argument is grounded in the language of several statutory sections. It begins with section 48(q)(1), the provision requiring that basis be reduced by the ITC. *See* 26 U.S.C. § 48(q)(1) (1988).[12] That section, as modified by section 49(d)(1)(A), provides that "if a credit is determined under section 46(a) . . . the basis of such property shall be reduced by [100 percent] of the amount of the credit so determined." *Id.* § 48(q)(1); *see id.* § 49(d)(1)(A).[13] Hence, to establish the amount by which the basis must be

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[12] In this subpart, citations to 26 U.S.C. §§ 46, 48, and 49 are to the versions of those sections in effect during 1986-90. In 1990, the transitional rules at issue here were removed from the Code. *See* Revenue Reconciliation Act of 1990, Pub.L. No. 101-508, § 11813(a), 104 Stat. 1388-400, 1388-536.

[13] Section 48(q)(1) states:

> For purposes of this subtitle, if a credit is determined under section 46(a) with respect to section 38 property, the basis of such property shall be reduced by 50 percent of the amount of the credit so determined.

Section 49(d)(1) states in part:

> In the case of periods after December 31, 1985, with respect to so much of the credit determined under section 46(a) with respect to transition property as is attributable to the regular investment credit (as defined in subsection (c)(5)(B))—
>
> > (A) paragraphs (1), (2), and (7) of section 48(q) and section 48(d)(5) shall be applied by substituting "100 percent" for "50 percent" each place it appears. . . .

Congress made technical amendments to § 49 in 1988 and incorporated the effective date of the original § 49 of the Tax Reform Act of 1986. *See* Technical and Miscellaneous Revenue Act of 1988(TAMRA), Pub.L. No. 100- 647, §§ 1002(e), 1019, 102 Stat. 3342, 3367 & 3593. The version of § 49 quoted above incorporates those amendments.

reduced, we must look to "the amount of the credit so determined" under section 46(a). That section, in turn, provides that "the amount of the investment credit determined under this section for any taxable year shall be an amount equal to" the sum of certain percentages of "the qualified investment" as "determined under subsection[ ] (c)." *Id.* § 46(a).[14] And subsection (c), in turn, defines "qualified investment" by reference to property "placed in service" during the taxable year. *See id.* § 46(c)(1).[15] Putting these provisions together, the IRS concludes that basis must be reduced by the amount of the credit "determined," and that this refers to the credit for which the property qualified during the taxable year in which the property was placed in service.

The interpretation the IRS advances here is the one reflected in Revenue Ruling 87-113 and adopted by the court below, *see MCI*, 26 F. Supp. 2d at 10, by the Court of Federal Claims, *see B.F. Goodrich v. United States*, 32 Fed. Cl. 571, 572 (Fed. Cl. 1995), and by the Federal Circuit, *see B.F. Goodrich*, 94 F.3d at 1549. In the words of the Federal Circuit, "[s]ince the investment tax credit is determined when the property is placed in service, and the statute mandates a

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[14] Section 46(a) states in part:

> For purposes of section 38, the amount of the investment credit determined under this section for any taxable year shall be an amount equal to the sum of the following percentages of the qualified investment (as determined under subsections (c) and (d)). . . .

[15] Section 46(c)(1) states in part:

> For purposes of this subpart, the term "qualified invest- ment" means, with respect to any taxable year . . .—
>
> (A) the applicable percentage of the basis of each new section 38 property (as defined in section 48(b)) placed in service during such taxable year. . . .

reduction in the basis when the credit is determined, we hold that the basis of transition property must be reduced when the taxpayer placed the property in service." *Id.* We find this interpretation to be a more than reasonable construction of the words of the statutory provisions.[16]

Telecom, of course, disagrees. In its briefs, it contends that the language of sections 46, 48 and 49 makes "clear" that the haircut on ITC carryforwards must be taken into account in calculating adjustments to depreciable basis. See Telecom Br. at 15. At oral argument, however, Telecom conceded that the statutory language is "confusing and technical." More important, Telecom was unable to cite any clear language in support of its position. Rather than rely on specific language, Telecom's fundamental contention is that the three sections must be read as an "integrated whole," and that if one does so, the validity of its position becomes manifest. *Id.* Telecom's argument is that section 49,[17] which imposes the haircut on the

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[16] As Telecom notes, *B.F. Goodrich* arose in a different procedural posture from the instant case. Here, the taxpayer initially reduced its basis by the full amount of the ITC allowed in the year the property was placed in service, and subsequently sought to increase the basis through a refund claim. In *B.F. Goodrich*, by contrast, instead of initially reducing its basis by the full amount of the ITC, the taxpayer reduced it only enough to reflect the 6.5% credit it "reasonabl[y] expect[ed]" to receive in the carryforward year. This procedural difference, however, did not drive the Federal Circuit's opinion. Although the court did hold that the statute "leaves no room for consideration of Goodrich's 'reasonable expectations,'" 94 F.3d at 1549, it reached that conclusion because, like the IRS, it read the statute as providing that an "investment tax credit is determined when the property is placed in service." *Id.*

[17] Section 49(c) states in part:

> (1) . . . . Any portion of the current year business credit under section 38(b) for any taxable year beginning after June 30, 1987, which is attributable to the regular investment credit shall be reduced by 35 percent.

ITC, must be understood to alter the basis adjustment provisions of section 48(q)(1) so that they reflect not only the haircut on current-year credits, but the haircut on credits carried forward as well.[18]

If this were Congress' intent, it would not be an unreasonable one. But as already noted, there is nothing in the language of any of the three statutory provisions that commands this interpretation. Rather, the clearest language in the statute indicates that the key question is when the credit is "determined," for that is the time at which the basis must be reduced. *See* 26 U.S.C. § 48(q)(1) (1988). And while it

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(2) . . . . Any portion of the business credit carryforward under section 38(a)(1) attributable to the regular investment credit which has not expired as of the close of the taxable year preceding the 1st taxable year of the taxpayer beginning after June 30, 1987, shall be reduced by 35 percent.

(3) . . . . In the case of any taxable year beginning before and ending after July 1, 1987—

(A) any portion of the current year business credit under section 38(b) for such taxable year, or

(B) any portion of the business credit carryforward under section 38(a)(1) to such year, which is attributable to the regular investment credit shall be reduced by the applicable percentage.

[18] Telecom further contends that there is no ground for the IRS' conclusion that § 49 should apply to §§ 46 and 48 in four other circumstances, while refusing to apply it as requested by Telecom. *See* Telecom Reply Br. at 5-6. But unlike the application Telecom seeks, in each of the other circumstances the application is clear from the text of the statute. *See* 26 U.S.C. § 49(a) (1988) (repealing the ITC); *id.* § 49(c)(1) ("reduc[ing] by 35 percent" the "current year investment credit" for tax years beginning after June 30, 1987); *id.* § 49(d)(1) (providing "full basis adjustment" by "substituting '100 percent' for '50 percent' each place it appears" in § 48(q)); *id.* §§ 49, 48(q) (adjusting basis to reflect current year business credit "determined under section 46(a)" as reduced by the percentages prescribed in § 49(c)).

would not be unreasonable to conclude that a credit is not "determined" until it is used, the government's contention that a credit is determined when it first becomes available, i.e., when the asset is placed in service, is also reasonable. Indeed, the government's construction is the more reasonable of the two in light of section 46(c)'s definition of qualified investment by reference to property "placed in service" during the taxable year.[19]

B

Telecom attempts to buttress its argument by directing our attention to the legislative history of the Tax Reform Act of 1986, which it insists "unambiguously" supports its position. See Telecom Br. at 20. According to Telecom, the Conference Report on the Act clearly demonstrates that Congress intended basis adjustments to reflect the haircut applied to carryforward credits.[20] That Report states, in pertinent part:

> *Full basis adjustment*
>
> A taxpayer is required to reduce the basis of property that qualifies for transition relief ("transition property") by the full amount of investment credits earned with respect to

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[19] Even Telecom concedes that a credit is at least "initially" determined at that time, since depreciation begins when the asset is placed in service, *see* 26 U.S.C. § 168(d)(1), (d)(4), and since the assets's basis must be calculated in order to take a depreciation deduction.

[20] Telecom also relies on language contained in an explanation of the Tax Reform Act prepared by the Staff of the Joint Committee on Taxation. *See* Staff of Joint Comm. On Taxation, 99th Cong., 2d Sess., General Explanation of the Tax Reform Act of 1986, at 123 (Comm. Print 1987). We need not consider what, if any, weight should be given to this post-enactment publication, *see Estate of Wallace v. Commissioner*, 965 F.2d 1038, 1050 n. 15 (11th Cir. 1992); *McDonald v. Commissioner*, 764 F.2d 322, 336 n. 25 (5th Cir. 1985), because the language cited by Telecom does not add anything material to the text of the Conference Report.

the transition property (after application of the phased-in 35-percent reduction, described below). . . .

Reduction of ITC carryforwards and credits claimed under transitional rules

. . . .

Under the conference agreement, the investment tax credit allowable for carryovers is reduced by 35 percent. The reduction in investment tax credit carryovers is phased in with the corporate rate reduction. The 35-percent reduction is fully effective for taxable years beginning on or after July 1, 1987. . . . The investment tax credit earned on transition property is reduced in the same manner as carryovers.

. . . .

As described above, a full basis adjustment is required with respect to the reduced amount of the investment tax credit. Thus, for transition property that is eligible for a 6.5 percent investment tax credit, the basis reduction would be with respect to the 6.5 percent credit, not the unreduced 10 percent credit.

H.R. Conf. Rep. No. 99-841, at II-63 to -64 (1986), U.S. Code Cong. & Admin. News at 4075, 4151-52 (underlining added).

Telecom argues that the first sentence quoted above indicates that a property's basis should be reduced to reflect the ITC haircut actually received in the carryforward year, since it states that a taxpayer must reduce the basis by the amount of the ITC "after application of the phased-in 35-percent reduction." *Id.* Although this is not an unreasonable reading, the sentence is not unambiguous. It does not state whether it refers to the phased-in reduction that applies to a credit used in the same year in which the property is placed in service (a current-year credit), or whether it refers to the phased-in reduction that applies to a carryforward. The

government, the district court, and the Federal Circuit all read the sentence as referring to current-year rather than carryforward credits—largely because the sentence is not in the subsequent section entitled "Reduction of ITC carryforwards and credits," but rather in the preceding section whose title does not mention carryforwards. *See B.F. Goodrich*, 94 F.3d at 1549; MCI, 26 F. Supp.2d at 11. Although Telecom rightly points to a number of indications that the sections are interrelated (for example, cross-references to material "described below" in the first section and to material "described above" in the second), these do not resolve the question with clarity because the referenced material does not itself indicate to which year it refers.

Telecom also points to the last paragraph of the quoted excerpt, which is contained in a section that does refer to both current-year credits and carryforwards. That sentence states that "for transition property that is eligible for a 6.5 percent investment tax credit, the basis reduction would be with respect to the 6.5 percent credit, not the unreduced 10 percent credit." H.R. Conf. Rep. No. 99-841, at II-64, U.S. Code Cong. & Admin. News at 4075, 4152 (emphasis added). But this sentence contains an ambiguity of its own: the meaning of the word "eligible." The government's view, and that of the other courts to have considered the question, is that a taxpayer is eligible for the full amount of the credit available to it in the year in which it places an asset in service. That the taxpayer may not be able to use the credit for which its property is eligible because of the peculiarities of the taxpayer's individual situation does not render the property itself ineligible. *See MCI*, 26 F. Supp.2d at 10; *B.F. Goodrich*, 32 Fed. Cl. at 573 ("When property is placed in service, it is eligible for the credit irrespective of whether the credit later may be carried forward and reduced."). We conclude that the government's

interpretation of the legislative history is at least as reasonable as that of Telecom.[21]

C

The final component of Telecom's argument is an appeal to two "principles of tax policy" which, it argues, require us to interpret the statute as Telecom does. But even if that kind of appeal could overcome the conclusions drawn above regarding the statutory language and legislative history, we would still find the tax policy principles at issue here too ambiguous and indeterminate to guide our construction.

Telecom's first contention is that depreciation deductions are governed by a principle of "full cost recovery"—i.e., allowing taxpayers to use depreciation to deduct the full amount of their investments—and that only its interpretation of the interaction between depreciation deductions and the ITC ensures such recovery. Telecom argues that "[i]n economic terms, the investment tax credit can be viewed as the government's co-investment in a taxpayer's property." Telecom Br. at 9. Thus, to determine the taxpayer's "share" of

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[21] The government also argues that Telecom's interpretation is foreclosed by Congress' failure to adopt a technical amendment, proposed by industry representatives during the development of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub.L. No. 100-647, 102 Stat. 3342, that would have permitted precisely the upward adjustment in basis Telecom seeks in this case. This post-1986 legislative history, however, "is a hazardous basis for inferring the intent of an earlier Congress." *Pension Benefit Guar. Corp. v. LTV Corp.*, 496 U.S. 633, 650, 110 S. Ct. 2668, 110 L. Ed.2d 579 (1990) (internal quotation marks and citations omitted). On the other hand, the statements submitted in the course of that failed effort do indicate that industry representatives believed the basis adjustment provisions were ambiguous and could be read as the IRS reads them here. See Staff of H.R. Comm. On Ways and Means, Written Comments on H.R. 2636, the Technical Corrections Act of 1987, Vol. 1, 100th Cong., 2d Sess., 418-27 & 429-32 (Comm. Print 1988).

the investment, the ITC must be deducted from the property's initial cost. To ensure full cost recovery, the taxpayer must then be permitted to deduct the balance as depreciation.

Translating this analysis to our simplified example, Telecom's contention is that, because it received a $65,000 credit on a $1,000,000 investment when it used its ITC in 1989 (when the ITC percentage was 6.5%), its share of the investment in the property was $935,000. Accordingly, $935,000 should be the basis used to calculate its depreciation deductions. Under the IRS' view, however, Telecom was required to subtract $100,000 from the asset's $1,000,000 cost to arrive at its basis, because the property was placed into service in 1986 (when the ITC percentage was 10%). According to Telecom, limiting its deductions to the resulting basis, $900,000, renders it unable to recover its full costs.

The government's first response is that depreciation deductions and the tax basis upon which they are computed must be determined by application of the provisions of the Internal Revenue Code, and not by appeal to notions of "full cost recovery"—a concept unmentioned in the Code. Whatever the merit of this dispute regarding the policy underlying the depreciation deduction,[22] however, the question

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[22] In *Lenkin v. District of Columbia*, we said that in interpreting a statutory section that "leaves for the courts the definition of basis for 'reasonable' depreciation allowances, their polestar is a basis that will enable the taxpayer to recover his investment in the asset." 461 F.2d at 1229 (interpreting D.C. Code § 47-1583e (Supp. IV 1971)). Sections 46, 48 and 49, however, do not leave the measure of basis "for the courts" to determine. Moreover, even Telecom concedes that a policy of full cost recovery cannot explain ERTA's 1981 elimination of the requirement that basis be reduced by salvage value, which plainly permits the recovery of more than the asset's full cost. *See* 26 U.S.C. § 168(f)(9) (1982). Telecom has a similar problem explaining ERTA's adoption of ACRS itself, which permits accelerated depreciation schedules over predetermined periods generally shorter than the useful life of an asset.

at issue here involves the interrelationship between the depreciation deduction and the ITC. While Telecom contends that the ITC should be viewed as "economically" equivalent to a government investment in the taxpayer's property, over the years Congress has offered a number of far more general rationales for the different combinations of depreciation deductions and ITCs it has enacted.[23] Indeed, even Telecom concedes that a principle of full cost recovery cannot explain why in most years prior to the enactment of TEFRA (1982) basis did not have to be reduced by ITC at all, or why between TEFRA and the Tax Reform Act of 1986 basis had to be reduced by only 50% of ITC. Fine-tuning the principle assertedly at issue here, Telecom argues that although these provisions permitted more than full cost recovery, Congress has never permitted less. This fine-tuning, however, weakens the overall coherence of the principle Telecom urges us to follow.

The government further argues that notwithstanding the basis adjustment Telecom was required to make, the company has already recovered more than the full cost of its investments. As the government notes, a tax credit is a dollar-for-dollar reduction in a taxpayer's tax liability. A deduction, on the

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and hence permits taxpayers to take full depreciation deductions before anasset's true useful life has ended. *See Simon v. Commissioner*, 68 F.3d 41, 44-45 (2d Cir. 1995); *Liddle v. Commissioner*, 65 F.3d 329, 334 (3d Cir. 1995); S. Rep. No. 97-144, at 48.

[23] *See, e.g.*, S. Rep. No. 99-313, at 96 (concluding that repeal of ITC would permit "[a] large reduction in the top corporate tax rate" and thereby "encourag[e] the efficient allocation of all resources"); S. Rep. No. 97-494, at 123, U.S. Code Cong. & Admin. News at 888 (concluding that under TEFRA, the combination of ACRS deductions and the ITC would "provide investment incentives comparable to those in a system without an income tax"); *cf. Simon*, 68 F.3d at 44-45 (noting that ERTA "altered the depreciation scheme" for "reasons other than sound accounting practice," particularly "as a stimulus for economic growth").

other hand, is a dollar-for-dollar reduction in the taxable income used to compute tax liability, and thus only reduces taxes by an amount equal to the deduction multiplied by the taxpayer's marginal rate. Hence, for a taxpayer like Telecom which was in the 34% marginal bracket, a tax credit of $10 is roughly equivalent to a tax deduction of $30. Applying this analysis to Telecom's actual tax situation, the government calculates that the combination of Telecom's depreciation deductions and the deduction-value of its ITCs substantially exceeded its total investment in the transition properties. *See* Gov't Br. at 40 (citing First Stipulation of Facts at 7 (J.A. 65)). Although Telecom rightly notes that (at least initially) Congress intended the ITC to have an incentive effect in addition to the benefit of depreciation deductions, the government's argument does take some of the air out of Telecom's claim not to have recovered its economic costs. Moreover, we must be cognizant of the fact that we are dealing with transition rules here, and that regardless of Congress' initial rationale for the combination of the ITC and depreciation deduction, we have little indication of what Congress' intentions were for the transition—other than there be a phase-out period that would inevitably involve some compromise between the goal of more efficient resource allocation, see S. Rep. No. 99-313, at 96, and a concern for fair treatment of investors' reasonable expectations.

Telecom contends that its interpretation of the statute is compelled by a second principle of tax policy as well—i.e., that similarly situated taxpayers must be treated in the same way. Taxpayers who place property in service in the same year should be treated the same, Telecom argues. This assertedly can only be accomplished if a taxpayer who cannot use a credit in that year is permitted to recover as much of his investment cost as one who can.

We are not persuaded by Telecom's argument. Taxpayers who place property in service in the same year are treated the

same under Revenue Ruling 87-113. All such taxpayers have available to them the same ITC and the same basis reduction, if they can use the credit in that year. The differential impact of which Telecom complains is not due to the revenue ruling, but rather to Telecom's individual tax situation—that is, to the fact that it had insufficient tax liability in the current year to make the ITC useful. Indeed, many of the Internal Revenue Code's provisions, although neutral on their face, have a differential impact depending upon taxpayers' individual circumstances, yet we generally do not regard that as a sign of inequitable disparate treatment.[24] In any event, the indeterminacy of the application of this principle to the question before us makes it an insufficient ground for rejecting the IRS' reasonable interpretation of the statutory language. *See B.F. Goodrich*, 94 F.3d at 1550 ("Nor are we convinced by Goodrich's hypotheticals that the alleged inconsistencies between so-called 'similarly situated taxpayers' warrant a construction which departs from the language enacted by Congress.")

In sum, we conclude that neither of Telecom's appeals to tax policy generates a principle sufficiently clear either to meet its burden of showing an entitlement to the deduction it seeks, or to overcome even a minimal level of deference to Revenue Ruling 87-113.[25]

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[24] Even the ITC, in its pre-1986 incarnation, had such a differential effect. Although a company that had to carry its credit forward several years would ultimately receive nominally the same ITC as a company that could use it immediately, it would enjoy significantly less present value.

[25] In light of our resolution of this issue, we need not consider the weight of the government's reference to its own "principle of tax policy"—namely, the principle that tax accounting generally proceeds on a year-by-year basis, and that tax determinations generally are based on events occurring in the taxable year. *See* Gov't Br. at 45 (citing 26 U.S.C. § 441).

V

As alternatives to its argument under sections 46, 48, and 49, Telecom offers two other grounds for its refund claims. First, it contends that even if those sections do not entitle it to reach back to the years it put its property into service, "section 168 and its accompanying regulations" entitle it to increase its basis beginning in 1989—the year it actually used the ITC. Telecom, however, does not point to any specific language in section 168, which sets out the details of the Accelerated Cost Recovery System, to support this proposition. Indeed, its briefs do not quote the language of section 168 at all.

Nor does Telecom point to any "accompanying regulations," at least not to any that have been enacted. Instead, it rests its claim upon the language of a proposed Treasury regulation, Prop. Treas. Reg. § 1.168-2(d)(3), 49 Fed Reg. 5940, 5945-46 (1984). That regulation, proposed in 1984, cannot serve as the basis of any entitlement because it was never adopted. But even if it could, it would have no application here. The proposed regulation provides for the redetermination of an asset's depreciable basis when the cost of the asset changes in a subsequent year, "e.g., due to contingent purchase price or discharge of indebtedness." *Id.* It offers as an example the case of a buyer who pays additional consideration for an asset after the year of its initial purchase because the purchase price was partially contingent on gross profits from the operation of the asset. Notwithstanding Telecom's claim that the haircut on ITC carryforwards represents the same "economic reality," there is no indication that the proposed regulation was intended to cover such a statutorily required reduction. That is hardly surprising, of course, since the Treasury Department proposed the regulation two years before Congress enacted the haircut.

As a second alternative, Telecom contends that it is entitled to a deduction pursuant to section 196(a), which permits

taxpayers to take a deduction for certain unused business credits. That section provides:

> If any portion of the qualified business credits determined for any taxable year has not, after the application of section 38(c), been allowed to the taxpayer as a credit under section 38 for any taxable year, an amount equal to the credit not so allowed shall be allowed to the taxpayer as a deduction for the first taxable year following the last taxable year for which such credit could, under section 39, have been allowed as a credit.

26 U.S.C. § 196(a). Section 38(c), referenced in section 196, bars a taxpayer from taking the ITC in excess of its income tax liability in a given year, and is the reason Telecom could not use the credit in 1986 or 1987. Telecom contends that section 38(c), "in conjunction with the application of the ITC haircut to the ITC carryforwards," barred it "from taking the full ITC to which it was originally entitled." Telecom Br. at 33. According to Telecom, "[s]ection 196(a) provides a remedy for this incomplete cost recovery: it allows taxpayers to take deductions in the amounts of the ITC reduced by the haircut, thereby fully recovering their investment costs." *Id.*

Without deciding whether section 196(a) can ever provide a deduction to make up for the amount of the ITC haircut,[26] we

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[26] The district court held that "[s]ection 196(a) authorizes deductions for carryforward credits that have expired" because the taxpayer had insufficient tax liabilities against which to offset them during the allowable carryforward period, "not for credits that are disallowed by reason of § 49(c)" and its statutory haircut. *MCI*, 26 F. Supp.2d at 13; *see* S. Rep. No. 97-494, at 123, U.S. Code Cong. & Admin. News at 888 ("A deduction will be allowed equal to the amount of the basis adjustment in the event a credit for which a basis adjustment has been made expires at the end of the 15-year carryover period."); Rev. Rul. 87-113 (concluding that "section 196 only applies to credits disallowed by reason of section 38(c), pertaining to tax limitation, and not to credits disallowed by reason of section 49(c)(1), (2) or (3)"); *see also* 26 U.S.C. § 49(c)(4)

agree with the Federal Circuit that the deduction contemplated by section 196(a) simply does not apply until, in the words of the section, "the first taxable year following the last taxable year for which such credit could, under section 39, have been allowed as a credit." Since section 39 provides that Telecom's credits may be carried forward for fifteen years,[27] the section 196 deduction is not available until the expiration of that fifteen-year period. *See B.F. Goodrich*, 94 F.3d at 1550-51; *see* also S. REP. NO. 97-494, at 123.

In support of the claim that it is nonetheless entitled to take the deduction in 1989, Telecom argues that the "unique nature" of the ITC haircut for carryforwards, which once applied reduces the ITC forever, should make the year before the haircut the "last taxable year" for which the full credit could have been allowed. Telecom Br. at 33-34. Whatever the reasonableness of this argument as a matter of tax policy, it cannot overcome section 39's express reference to the fifteen-year carryforward period. Accordingly, we reject Telecom's final effort to secure a deduction.

VI

We uphold the interpretation of the Tax Reform Act reflected in Revenue Ruling 87-113, and reject the two alternative grounds Telecom offers in support of its refund claims. The decision of the district court, granting summary judgment for the United States, is therefore affirmed.

(1988) ("The amount of the reduction of the regular investment credit under paragraphs (1) and (2) shall not be allowed as a credit for any taxable year.").

[27] *See* 26 U.S.C. § 39(a)(1) (1988). Under the current Code, the carryforward period is 20 years. *See id.* § 39(a)(1) (Supp. III 1997).

UNITED STATES DISTRICT COURT,
DISTRICT OF COLUMBIA

MCI COMMUNICATIONS CORPORATION and Subsidiaries, Plaintiff,
v.
UNITED STATES of America, Defendant.
TELECOM*USA, INC. and Subsidiaries, Plaintiff,
v.
UNITED STATES of America, Defendant.

Civil Action Nos. 96-259 SSH, 96-258 SSH.

June 3, 1998

OPINION

STANLEY S. HARRIS, District Judge.

Before the Court are the parties' cross-motions for summary judgment, corresponding oppositions, plaintiffs' reply, and plaintiffs' notice of recent authority. After careful consideration of the entire record, the Court denies plaintiffs' motion for summary judgment and grants defendant's motion for summary judgment. Although "[f]indings of fact and conclusions of law are unnecessary on decisions of motions under Rule . . . 56," the Court nevertheless sets forth its analysis. *See* Fed. R. Civ. P. 52(a).

BACKGROUND

Prior to 1986, when the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085 (1986), was passed, the tax code encouraged taxpayers to invest in certain property or assets by offering two interrelated programs—the investment tax credit

("ITC"), and the accelerated cost recovery system ("ACRS").[1] The ITC provided taxpayers with a 10% tax credit for investing in qualified assets, and the related ACRS program allowed taxpayers to deduct a portion of an asset's value during each year of the asset's life.

Under the ACRS program, however, the asset was still considered to be worth its full cost, even after the taxpayer had received a tax credit that reduced the "real" cost of the asset. Thus, taxpayers were getting a double benefit because they received a tax credit, and they also were allowed to deduct depreciation of the full cost of the asset. For example, if a taxpayer's cost for an asset were $1,000, the taxpayer (a) would receive an investment tax credit of $100 (10% of the $1,000 cost of the asset), and (b) could deduct, through depreciation deductions, $1,000 (the full cost of the asset) over the life of the asset. *See* I.R.C. §§ 46(a)(1) and 46(b)(1).[2]

In 1982, Congress passed the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (1982) ("TEFRA"), which provided for an adjustment to the property's "basis," the value of the property used in determining depreciation deductions.[3] Even after TEFRA was passed, however, a substantial amount of double benefit was still available.

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[1] The ITC was originally created in 1962 by § 2 of the Revenue Act of 1962, Pub.L. No. 87-834, 76 Stat. 960. ACRS deduction rules were part of §§ 167 and 168 of the 1954 Code.

[2] For the sake of brevity, sections of the code that have been repealed, such as this one, will not be repeatedly identified with the label "former."

[3] TEFRA added to the Code a new provision, § 48(q)(1), which provided in pertinent part that "if a credit is determined . . . with respect to . . . property, the basis of such property shall be reduced by 50 percent of the amount of the credit so determined."

This led many taxpayers to direct investments into categories of assets that qualified for the special treatment of the ITC and ACRS programs, which was considered to have had a detrimental effect on the economy. *See, e.g.*, S. Rpt. 99-313, 99th Cong. 2d Sess., at 96 (1986). Tax-favored sectors attracted a disproportionate share of investment, to the detriment of tax-disadvantaged sectors.

Congress responded by passing the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085 (1986), which repealed the tax credit for new purchases and lowered overall corporate tax rates. Because some taxpayers already had committed to substantial asset acquisitions based on the expected benefits of the ITC program, Congress set up a complex series of transition rules to phase out the ITC over time. Under those rules, taxpayers wishing to receive the full value of ITC credits were required to place the qualifying assets into service and take the credits in a timely manner. Qualifying assets, i.e., those purchased prior to 1986, that were placed into service before 1987, were allowed the full 10% credit, while those put into service during 1987 earned a reduced credit of 8.25%. Those put into service during 1988 or later received a 6.5% credit. This phasedown, known colloquially as the "ITC haircut," thus encouraged taxpayers to put qualified assets into service sooner rather than later. *See* I.R.C. § 49.

Under these transitional rules, Congress also eliminated the double benefit by requiring basis reductions to equal 100% of the credits earned. This meant that a qualifying asset costing $1,000, put into service in 1986, would earn a $100 credit, and its basis would be reduced by the entire $100, to $900.

Tax credits, such as those at issue in the ITC program, can generally be used only to reduce income taxes owed; they cannot be used to reduce taxes to less than zero so as to generate a tax refund. Absent a rule specifically allowing the credits to be carried forward to future years (or carried back to previous years), the tax credit would be lost. The rules of the

ITC program contained both carryback and carryforward rules, and until 1986 they were simple: credits could be carried back up to three years or forward up to fifteen years. I.R.C. § 39(a). Taxpayers unable to carry credits back commonly saved their credits until they generated sufficient profits against which to offset them, because other than reductions in value due to inflation, the credits retained their full value. One of the 1986 changes, however, was the application of the ITC haircut to these types of unused tax credits. A 10% ITC credit earned in 1986, but not used that same year, shrank to 8.25% in 1987, and to 6.5% in 1988.

Because the corporate tax rates were being lowered, taxpayers who were losing the value of their ITC credits were simultaneously benefitting from gradually lowering tax rates. However, the transition rules set up a system that reduced the basis of assets in the year when the ITC was earned, instead of when the ITC was actually used. For example, a taxpayer who put a $1,000 asset into service in 1986 earned a 10% ITC credit of $100, but had to reduce the taxable basis of the asset (for ACRS purposes) by that same amount, to $900. Two years later, when the taxpayer was able to use the credit, it had been reduced by the ITC haircut from $100 down to $65, even though the asset's basis had already been reduced by the full $100 and could not be readjusted to take into account that the taxpayer had actually utilized only $65 of credit. Such a taxpayer therefore had a basis of $935 for the asset ($1,000 paid in 1986, minus the $65 allowed as a credit in 1988), but had to depreciate the asset as if it had paid $900 ($1,000 paid in 1986, minus the $100 ITC earned in 1986), thus losing $35 of basis that would otherwise have been used for deduction calculations.

Plaintiffs MCI and TELECOM*USA filed claims with the IRS in 1994 seeking refunds to recover such lost bases.[4] The IRS denied their claims entirely, and, after plaintiffs had exhausted their administrative remedies, they filed this action.[5]

Plaintiffs assert three grounds for recovering the lost basis of their investment properties. Plaintiffs first assert that they should be allowed to amend their returns for the years in which qualifying assets were placed into service by upwardly adjusting their assets' bases to reflect the amount of ITC actually utilized. (Count I) Plaintiffs alternatively assert that they should be allowed to count the lost basis as additional investment, warranting redetermination of the basis (Count II), or deduct the amount of the credit that was taken away due to the ITC haircut (Count III).

Plaintiffs contend that Congress did not intend for them to lose basis in their assets. They contend that a proper reading of the code leads to the interpretation they seek. They ask the Court to disagree with IRS Revenue Ruling 87-113, 1987-2 C.B. 33, and the reasoning of the Federal Circuit in *B.F. Goodrich Co. v. United States*, 94 F.3d 1545 (Fed.Cir. 1996). Defendant responds that the tax code does not allow for recovery of plaintiffs' lost basis. Defendant also requests that the Court exclude from its consideration a declaration of Kenneth L. Wertz, plaintiffs' expert witness.

STANDARD OF REVIEW

Summary judgment may be granted only if there is no genuine issue of material fact and the moving party is entitled

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[4] TELECOM*USA filed an additional Claim for Refund in 1995 that also was rejected on the same grounds.

[5] MCI and TELECOM*USA filed separate Civil Actions, Nos. 96-258 and 96-259. Pursuant to the Court's Order of July 17, 1996, they were consolidated.

to judgment as a matter of law. Fed. R. Civ. P. 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 323-24, 106 S. Ct. 2548, 2553, 91 L. Ed.2d 265 (1986). Taxpayers carry the burden of establishing that Congress clearly authorized the benefits or deductions they seek. *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440, 54 S. Ct. 788, 78 L. Ed. 1348 (1934); *Interstate Transit Lines v. Commissioner of Internal Revenue*, 319 U.S. 590, 593, 63 S. Ct. 1279, 87 L. Ed. 1607 (1943). Exemptions from taxation are to be construed "narrowly," *Bingler v. Johnson*, 394 U.S. 741, 751-52, 89 S. Ct. 1439, 22 L. Ed.2d 695 (1969), and are "not to be implied," but "unambiguously proved." *United States v. Wells Fargo Bank*, 485 U.S. 351, 354, 108 S. Ct. 1179, 99 L. Ed.2d 368 (1988).

ANALYSIS

I. Admissibility of The Wertz Declaration

Before turning to each of plaintiffs' claims, the Court first addresses defendant's allegation that the Wertz declaration is "irrelevant and inadmissible." Def's Mem. in Opp'n to Pls.' Mot. for Summ. J. at 4. Defendant claims that this declaration falls outside the scope of expert testimony permitted by Federal Rule of Evidence 702 and therefore must be excluded.

Rule 702 provides that "if scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise." The advisory committee's note to Rule 702 states that

> [t]here is no more certain test for determining when experts may be used than the common sense inquiry whether the untrained layman would be qualified to determine intelligently and to the best possible degree the particular issue without enlightenment from those having a

> specialized understanding of the subject involved in the dispute

Fed R Evid 702 advisory committee's note It is well settled that determining the admissibility of expert opinions falls within the broad discretion of the trial court *See, e.g., Steinberg v. Indemnity Ins. Co. of North America*, 364 F 2d 266 (5th Cir 1966), *United States v. Hearst*, 412 F Supp 893 (N D Cal 1976)

Defendant cites *United States v. Hawley*, 592 F Supp 1186, 1190 (D S D 1984), *aff'd*, 768 F 2d 249 (8th Cir 1985), to support its contention that the Court should disregard Wertz's declaration Although the court in *Hawley* excluded testimony from that defendant's expert because it would have been irrelevant and "would not have assisted the trier of fact to understand the evidence," *Hawley*, 592 F Supp at 1190, that case stands for the proposition that a court has broad discretion to determine whether proffered evidence will be of assistance in understanding highly technical evidence Such evidence should, of course, be excluded when it is in fact nothing more than a legal conclusion[6] The declaration has assisted the Court in understanding the technical tax issues presented by this action, and the Court declines to exclude it

II. Count I

In Count I, plaintiffs contend that they should be able to amend their returns for the years in which their property was placed in service to reflect the amount of the ITC they actually received This argument is very similar to one rejected by the Court of Appeals for the Federal Circuit in *B.F. Goodrich*, 94

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[6] Much of the instant declaration is background information to assist the Court To the extent that the Wertz declaration does contain some legal conclusions that are irrelevant, such conclusions have been excluded from consideration

F.3d at 1545. Plaintiffs argue that *Goodrich* is inapposite and was wrongly decided, but the Court disagrees.

In that case, plaintiff B.F. Goodrich Company ("Goodrich") purchased assets prior to 1986, but did not put them into service until 1986 and 1987. Since those assets qualified for the transitional ITC program, they earned Goodrich a 10% credit (for assets put into service in 1986), and an 8.25% credit (for those put into service in 1987). Knowing that it was unable to use those credits in either 1986 or 1987, Goodrich anticipated that they would be subject to the haircut provisions and would be reduced to 6.5% when they were eventually used in 1988 or beyond. Goodrich therefore reduced the basis of those properties by the 6.5% it concluded it eventually would be able to use, instead of by the 10% the Code required.

Goodrich argued that the use of the word "determined" in I.R.C. § 48(q) allowed it to calculate the amount of basis reduction relative to the credit that eventually would be taken instead of the credit earned. Similarly, plaintiffs here contend that the credit is not really "determined" until it is actually utilized. The Court rejects that reading of the Code, and agrees with the Federal Circuit that an investment tax credit is determined when the property is placed in service and that an asset's basis must be reduced by the full amount of an ITC credit in the year it is "determined." *See Goodrich*, 94 F.3d at 1549.

I.R.C. § 48(q) provides that "if a credit is determined under 46(a) . . . , the basis of such property shall be reduced by 100% of the amount of the credit so determined." I.R.C. § 46(a) specifies that "the amount of the investment credit determined under this section for any taxable year shall be an amount equal to the sum" of certain percentages of the qualified investment, which consists of the property placed in service during that taxable year. Thus, under I.R.C. § 46(a), a credit is determined in the year the qualified asset is placed into service, and I.R.C. § 48(q) therefore mandates a reduction in basis that same year,

when the credit is determined. This was the conclusion of the IRS in Revenue Ruling 87-113, 1987-2 C.B. 33-35, the conclusion of the Court of Federal Claims in *B.F. Goodrich Co. v. United States*, 32 Fed. Cl. 571 (Fed. Cl. 1995), the conclusion of the Federal Circuit in *B.F. Goodrich*, 94 F.3d at 1545, and it is the conclusion of this Court as well.

Plaintiffs contend that *Goodrich* is inapposite because the plaintiff in that case sought to take the deduction before its credits were reduced by the ITC haircut, while the instant plaintiffs waited until the credits were actually subjected to the ITC haircut to do so. *Goodrich* did reject the "reasonable expectation" theory proffered by the plaintiff in that case, but the central holdings there were that credits are "determined" in the year the assets are placed in service, and that tax credits must be subtracted from assets' basis the same year in which such assets are put in service.

The Goodrich court noted that its conclusion was similar to that promulgated by IRS Revenue Ruling 87-113, 1987-2 C.B. 33-35, in which a taxpayer faced a factually similar situation. In that ruling, the IRS stated:

> Because the property was placed in service after December 31, 1985, [taxpayer] must reduce its depreciable basis in the property to $900,000 under the 100-percent-of-credit basis reduction rule in section 49(d)(1) of the Code. The basis must be reduced in the year the property is placed in service, in 1986. However, because it is carried forward to 1988, the $100,000 credit is subject to the 35-percent credit reduction under section 49(c)(2). Thus, the credit eventually taken by [taxpayer] in 1988 is $65,000 ($100,000 reduced by 35 percent), even though [taxpayer] reduced its basis in the property by $100,000 in 1986. [Taxpayer] is not allowed to increase its basis in the property to reflect the reduction in the investment tax credit carryforward under section 49(c)(2).

Goodrich, 94 F.3d at 1550. Plaintiffs' contention that *Goodrich* is limited to the issue of reasonable expectations is incorrect.

Plaintiffs also contend that *Goodrich* was wrongly decided. They rely on a piece of legislative history for support, but their reliance is misplaced. Plaintiffs here, like the plaintiff in *Goodrich*, point to an apparently contradictory passage in the legislative history as evidence that their interpretation should prevail:

> A taxpayer is required to reduce the basis of property that qualifies for transition relief ("transition property") by the full amount of investment credits earned with respect to the transition property (after application of the phased in 35-percent reduction described below).

H.R. Rep. No. 841, 99th Cong., 2d Sess. II-63 (1986). Plaintiffs contend that this passage indicates that asset basis should be reduced by the tax credits as carried forward, instead of when initially determined. Though the Court notes that any use of legislative history in a case such as this is unnecessary given the clarity of the text, it nonetheless reaches the same conclusion as the *Goodrich* court. When read in context with the nearby text, the passage at issue clearly deals with current-year credits, not carryforward credits, and is thus irrelevant. As the *Goodrich* court noted:

> The quoted excerpt is the first sentence of a paragraph titled "Full Basis adjustment." The next subsection is titled "Reduction of ITC carryforwards and credits claimed under transitional rules." The existence of a separate subsection expressly devoted to carryforward credits clearly implies, as the Government argues, that the quoted excerpt—which is part of the preceding section—deals with different subject matter, namely current-year credits.

Goodrich, 94 F.3d at 1549. When read in its proper context, the legislative history offered by plaintiffs is unpersuasive, and

plaintiffs' first basis for a refund, allowance of additional ACRS deductions based on the interpretation discussed, is therefore denied

III. Count II

Plaintiffs' second theory for recovery, treating the taxpayer's increased share of costs as an additional investment requiring a redetermination of basis, is putatively based on I R C § 168 and proposed Treas Reg 1 168-2(d)(3)(i) These sections allow for redeterminations of the unadjusted basis of property where a taxpayer's investment in a property has changed, such as where there is a contingent purchase price and a discharge of indebtedness For example, proposed Treas Reg § 1 168-2(d)(3)(ii) contains an example of additional consideration being paid to a seller after the asset began producing a certain level of profits *See* Pls.' Mot for Summ J at 33

Here, the government, through the ITC haircut, has reduced the amount of tax credits and depreciation allowances, this has increased the cost of carrying the assets That the amount of the ITC carryforward is statutorily reduced, however, does not affect the basis that is determined at the time the property is placed into service Adjustments for this type of change are neither in the text, contemplated in the examples, nor consistent with other sections of the tax code

Although defendant's motion for summary judgment responds to plaintiffs' second claim with fewer than thirty lines of text, there is no detailed analysis to perform on this count Plaintiffs have failed to carry the substantial burden of taxpayers seeking exemptions from taxation *See New Colonial Ice*, 292 U S at 440, 54 S Ct 788; *Interstate Transit Lines*, 319 U S at 593, 63 S Ct 1279; *Bingler*, 394 U S at 751-52, 89 S Ct 1439; *Wells Fargo Bank*, 485 U S at 354, 108 S Ct 1179 Plaintiffs' second basis for a refund,

counting the lost basis as additional investment based on I R C § 168 and Prop Reg 1 168-2(d)(3)(i), is therefore denied

IV. Count III

Plaintiffs' third theory for recovery is essentially the same as the alternate theory rejected by the Federal Circuit in *Goodrich*, 94 F 3d at 1550 There, as here, the plaintiff relied on I R C § 196(a) to deduct the amount of the ITC that was lost to the ITC haircut That section allows taxpayers to deduct a portion of a credit that has expired due to non-use It provides in relevant part

> Section 196 Deduction for certain unused business credits
>
> (a) ALLOWANCE OF DEDUCTION —If any portion of the qualified business credits determined for any taxable year has not, after application of section 38(c), been allowed to the taxpayer as a credit under section 38 for any taxable year, an amount equal to the credit not so allowed shall be allowed to the taxpayer as a deduction for the first taxable year following the last taxable year from which such credit could, under section 39, have been allowed as a credit
>
> (c) QUALIFIED BUSINESS CREDITS —For purposes of this section, the term "qualified business credits" means—
>
> (1) the investment credit determined under section 46(a) (but only to the extent attributable to property the basis of which is reduced by section 48(q)),
>
> (d) SPECIAL RULE FOR INVESTMENT TAX CREDIT —In the case of the investment credit determined under section 46(a) (other than a credit to which section 48(q)(3) applies), subsection (a) shall be applied by substituting "an amount equal to 50 percent of" for "an amount equal to"

Thus, if a § 38(c) limitation prevents a taxpayer from using an investment tax credit, § 196 authorizes a future deduction in an amount equaling 50 percent of the credit disallowed

This Court is in agreement with the *Goodrich* court, which evaluated the same provisions and concluded that the section in question dealt with carryforward credits, not statutory reductions such as those imposed on plaintiffs That court stated

> We conclude that Goodrich cannot avail itself of the § 196 deduction. According to § 196(a), the deduction shall be allowed "for the first taxable year following the last taxable year for which the credit could, under § 39, have been allowed." Section 39 specifies a 15-year period during which unused credits may be carried-forward. Thus, the "last taxable year" referred to in § 196(a) is, in the words of § 39, "15 taxable years following the unused credit year." We agree with the Court of Federal Claims that the statute permits a deduction only at the end of the 15-year carryforward period. The requirement of expiration of the [illegible] period is not, as Goodrich argues in its brief,

[illegible] at 1550 Plaintiffs' investment tax credits [illegible] rather, they were statutorily reduced. Section [illegible] deductions for carryforward credits that have expired, not for credits that are disallowed by reason of § 49(c). Moreover, to the extent that Congress mentioned the reduction of ITC tax credits being carried forward, it provided that the reduction could not be allowed as a credit in the [illegible] year. *See* I.R.C. § 49(c)(4)(A).

Plaintiffs contend that the *Goodrich* court [illegible] overlooked the fact that once the ITC haircut is imposed [illegible] imposed forever, and thus there should be no need to wait [illegible] 15 years to take a deduction. This is a mischaracterization of § 196, which applies "only where the credit has not, after the

application of section 38(c), been allowed . . . as a credit." Section 38(c) does not apply to plaintiffs' lost credits, and thus does not allow a deduction under § 196. Plaintiffs have not met the burden of proving that a deduction under § 196 is authorized. Plaintiffs' third basis for a refund, deducting the amount of the credit that was taken away due to the ITC haircut, is therefore denied.

CONCLUSION

After viewing all of the evidence presented in a light most favorable to plaintiffs, the Court concludes that plaintiffs have failed to establish that they are eligible for the adjustments or deductions sought. The proper route to the tax treatment plaintiffs seek is through the legislative branch.

RELEVANT STATUTORY PROVISIONS

Former I.R.C. § 46
(in pertinent part)

Amount of credit.

(a) Amount of investment credit

For purposes of section 38, the amount of the investment credit determined under this section for any taxable year shall be an amount equal to the sum of the following percentages of the qualified investment (as determined under subsections (c) and (d))

(1) the regular percentage,

(2) in the case of energy property, the energy percentage, and

(3) in the case of that portion of the basis of any property which is attributable to qualified rehabilitation expenditures, the rehabilitation percentage.

(b) Determination of percentages

For purposes of subsection (a) -

(1) Regular percentage. The regular percentage is 10 percent.

Former I.R.C. § 48
(in pertinent part)

Definitions; special rules.

(q) Basis adjustment to section 38 property.

(1) In general. For purposes of this subtitle, if a credit is determined under section 46(a) with respect to section 38

property, the basis of such property shall be reduced by 50 percent of the amount of the credit so determined.

(2) Certain dispositions. If during any taxable year there is a recapture amount determined with respect to any section 38 property the basis of which was reduced under paragraph (1), the basis of such property (immediately before the event resulting in such recapture) shall be increased by an amount equal to 50 percent of such recapture amount. For purposes of the preceding sentence, the term "recapture amount" means any increase in tax (or adjustment in carrybacks or carryovers) determined under section 47.

"Sec 49. TERMINATION OF REGULAR PERCENTAGE.

"(a) General rule.

"For purposes of determining the amount of the investment tax credit determined under section 46, the regular percentage shall not apply to any property placed in service after December 31, 1985.

"(b) Exceptions.

"Subject to the provisions of subsections (c) and (d), subsection (a) shall not apply to the following:

"(1) Transition property. Property which is transition property (within the meaning of subsection(e)).

"(2) Qualified progress expenditure for periods before January 1, 1986. In the case of any taxpayer who has made an election under section 46(d)(6), the portion of the adjusted basis of any progress expenditure property attributable to qualified progress expenditures for periods before January 1, 1986.

"(3) Qualified timber property. The portion of the adjusted basis of qualified timber property which is treated as section 38 property under section 48(a)(1)(F).

"(c) 35-percent reduction in credit for taxable years after 1986.

"(1) Reduction in current year investment credit. Any portion of the current year business credit under section 38(b) for any taxable year beginning after June 30, 1987, which is attributable to the regular investment credit shall be reduced by 35 percent.

"(2) Unexpired carryforwards to 1st taxable year beginning after June 30, 1987. Any portion of the business credit carryforward under section 38(a)(1) attributable to the regular investment credit which has not expired as of the close of the taxable year preceding the 1st taxable year of the taxpayer beginning after June 30, 1987, shall be reduced by 35 percent.

"(3) Special rule for taxable years beginning before and ending after July 1, 1987. In the case of any taxable year beginning before and ending after July 1, 1987 —

"(A) any portion of the current year business credit under section 38(b) for such taxable year, or

"(B) any portion of the business credit carryforward under section 38(a)(1) to such year,

"which is attributable to the regular investment credit shall be reduced by the applicable percentage.

"(4) Treatment of disallowed credit.

"(A) In general. The amount of the reduction of the regular investment credit under paragraphs (1) and (2) shall not be allowed as a credit for any taxable year.

"(B) No carryback for years straddling July 1, 1987; gross up of carryforwards. In any case to which paragraph (3) applies —

"(i) the amount of the reduction under paragraph (3) may not be carried back to any taxable year, but

"(ii) there shall be added to the carryforwards from the taxable year (before applying paragraph (2)) an amount equal to the amount which bears the same ratio to the carryforwards from such taxable year (determined without regard to this clause) as —

"(I) the applicable percentage, bears to

"(II) 1 minus the applicable percentage.

"(5) Definitions and special rules. For purposes of this subsection —

"(A) Applicable percentage. The term "applicable percentage" means, with respect to a taxable year beginning before and ending after July 1, 1987, the percentage which bears the same ratio to 35 percent as —

"(i) the number of months in such taxable year after June 30, 1987, bears to

"(ii) the number of months in such taxable year.

"(B) Regular investment credit.

"(i) In general. The term "regular investment credit" means the credit determined under section 46(a) to the extent attributable to the regular percentage.

"(ii) Exception for timber property. The term "regular investment credit" shall not include any portion of the regular investment credit which is attributable to section 38 property described in section 48(a)(1)(F).

"*(d) Full basis adjustment.*

"(1) In general. In the case of periods after December 31, 1985, with respect to so much of the credit determined under section 46(a) with respect to transition property as is attributable to the regular investment credit (as defined in subsection (c)(5)(B)) —

"(A) paragraphs (1), (2), and (7) of section 48(q) and section 48(d)(5) shall be applied by substituting "100 percent" for "50 percent" each place it appears, and

"(B) sections 48(q)(4) and 196(d) shall not apply.

"(2) Special rule for qualified progress expenditures. If the taxpayer made an election under section 48(q)(4) with respect to any qualified progress expenditures for periods before January 1, 1986 —

"(A) paragraph (1) shall not apply to the portion of the adjusted basis attributable to such expenditures, and

"(B) such election shall not apply to such expenditures for periods after December 31, 1985.